Study on Development Strategy and Policy for Vietnam's Automobile Industry in the context of joining WTO

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Abbreviations

ACIS	Automotive Competitiveness and Investment Scheme
AFTA	ASEAN Free Trade Area
AICO	ASEAN Industrial Cooperation Scheme
ASEAN	The Association of Southeast Asian Nations
ASCM	Agreement on Subsidy and Coutervailing Measure
AUV	Asian Utility Vehicle
BOI	Board of Investment
BTA	Bilateral Trade Agreement
CBU	Completely Build-up Unit
CEPT	Common Effective Preferential Tariff
CIE	Central Institute of Economic Management
CKD	Complete Knockdown
DAW	Dongfeng Auto Works
FAW	First Auto Works
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GDC	General Department of Customs
GDP	Gross Domestic Product
GEL	General Exception List
GM	General Motors
FTZ	Free Trade Zone
HCMC	Ho Chi Minh City
ICT	Information, Communication and Technology
IKD	Incomplete Knockdown
IL	Inclusion List
IMF	International Monetary Fund
IPS	Institute for Industry Policy and Strategy
IT	Information Technology
JAMA	Japan Automobile Manufacturers Association, Inc.
JERI	The Japan Economic Research Institute
JETRO	Japan External Trade Organization
JICA	Japan International Cooperation Agency
JODC	Japan Overseas Development Corporation
KD	Knock Down
METI	Ministry of Economy, Trade and Industry
MOF	Ministry of Finance

MOI	Ministry of Industry
MOT	Ministry of Trade
MPI	Ministry of Planning and Investment
SAW	Shanghai Auto Works
SCT	Special Consumption Tax
SL	Sensitive List
SME	Small- or Medium-sized Enterprise
SOCB	State-owned Commercial Bank
SOE	State-owned Enterprise
TAI	Thailand Automotive Institute
TAIC	Tianjin Automotive Industry Cooperation
TEL	Temporary Exclusion List
TMV	Toyota Motor Vietnam
TRIM	Trade-Related Investment Measures
TRIPs	Trade-Related Aspects of Intellectual Property Rights
UNIDO	United Nations Industrial Development Organization
USD	U.S. Dollar
VAMA	Vietnam Automobile Manufacturers' Association
VAT	Value Added Tax
VIDAMCO	Vietnam Daewoo Motor Co., Ltd.
VINDACO	Vietindo Daihatsu Automotive Corporation
VISUCO	Vietnam Suzuki Corporation
VMC	Vietnam Motors Corporation
VND	Vietnamese Dong
VW	Volkswagen
WTO	The World Trade Organization

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Executive Summary

Introduction

With the globalization of the economy, Vietnam's automobile industry has no choice but to increase its competitive position in world markets within a very short period, which certainly is not an easy task. It is indispensable, therefore, for the government to implement measures for the automobile industry development, which would also lead to promotion of supporting industry such as car parts manufacturing. Since the automobile industry will not really take root in the country unless it is given the full backing of well-developed supporting industry, it is important to work out the overall auto industry development policy from two points of view: vehicle production and supporting industry development. The progress made in the coming ten years will thus be the key to ascertaining the future of Vietnam's automobile industry and will underpin its development in the following ten years.

Chapter 1: The situation of the automobile industry in Vietnam

Automobile industry, one of the key industries, requires government support in order to develop competitiveness in a country that is still at the early stage of industrialization, like Vietnam. Such preferential treatment would be also approved for a greater positive effect that the automobile industry would bring about in the future. The automobile industry, for example, has an inter-industry linkage effect; provides greater investment efficiency and higher value added compared with other industries; has great potential in developing a wide range of supporting industry; expands employment opportunities; and facilitates transfer of technology. The automobile industry is one of the keys to the industrialization of Vietnam.

There are eleven car assembly manufacturers currently operating in Vietnam, all of which are FDI companies that started operations between 1992 and 1997, with the total automobile sales by the joint-venture companies increased from about 6,000 units in 1999 to 40,141 units in 2004.

Chapter 2: Factors that influence the automobile industry in Vietnam

SITUATION OF DOMESTIC DEMAND

Car sales remained as low as 6,000 units or less between 1996 and 1998, before expanding to 26872, 42,556, 40,141 units in 2002, 2003, 2004 respectively. The remarkable expansion is due to the enactment of a corporate law in 2000 that led to an increase in the number of newly registered private companies that aroused corporate demand. This expansion, combined with the development of social infrastructure and other factors, has increased Vietnam's overall car consumption.

The main characteristics of Vietnam's automobile market are (1) its assembly makers are not enjoying economies of scale, due to low production levels and the government's late start in promoting automobile industry and (2) the unit price of automobiles is extremly high compared to that of other countries because of the industry's high dependence on the high protection. The high rate of protection on auto industry initially attracted fourteen foreign auto-makers such as Toyota, Ford... to set up joint ventures in Viet Nam. However, high protection resulted in high production costs, rather than high profit that seems to lead the industry to no where.

PROBLEMS IN THE INFRASTRUCTURE AVAILABILITY AND TRAFFIC RULES

The road improvement and paved road ratios of Vietnam remain very low compared to those of ASEAN 4 countries. Further delay in road improvement will not only obstruct the

progress of motorization, but also prevent quick transportation and goods distribution, which will also impede the progress of Vietnam's industrialization, including exports and imports. As well, in order to avoid a rapid increase in traffic accidents, Vietnam needs to meet global standards in terms of traffic laws and regulations and its systems for automobile inspection and drivers licensing.

Improvement in availability of parking space is also indispensable for realization of a motorized society, and both public and private parking spaces need to be built. As well, the improvement of port and harbor infrastructures is essential for the progress of Vietnam's entire industry, the promotion of which is awaited.

CHANGES IN THE TRADE ENVIRONMENT

With the globalization of world trade and with AFTA and WTO rules becoming the norm internationally, it is becoming more difficult for Vietnam to adopt protective industrial policy for promoting the automobile industry. In ASEAN countries such as Thailand, Malaysia, the Philippines and Indonesia, on the other hand, an automobile parts complementation scheme has been in progress under the same AFTA and WTO rules, with each country specializing in certain products.

As for AFTA, Vietnam is expected to lower its import duties to 0-5 percent by 2006 following the CEPT scheme. The automobile parts industry, will be able to enjoy the merit of low tariff rates until 2006 through the active use of the AICO scheme, which is expected to reduce costs for importing automobile parts.

As regards Vietnam's accession to WTO, negotiations are under way. Once Vietnam gains membership, it will have to abide by the requirements of trade liberalization and non-discrimination between foreign and domestic products, which implies that Vietnam will no longer be able to adopt protective measures, except for tariff measures, in order to promote its strategic industries. Application of GATT Article 18 (Exceptional Measures on Accession for Countries in the Early Stages of Development) is to be approved through case-by-case negotiation. However, based on China's experience in negotiating its WTO accession, it seems very unlikely for Vietnam to get the approval for the protection of its automobile industry.

As the Vietnam-US bilateral trade agreement (BTA) came into effect in 2001, it is expected that Vietnam will not only expand its exports to the US, but also receive an increased amount of FDI from the US. On the other hand, the BTA includes a provision on abolition of some protective measures. For example, Vietnam must abolish the 95 percent SCT exemption, which is currently granted to domestically assembled cars, within three years from the entry into force of the agreement and must also eliminate quantitative import restrictions on CBU vehicles within five years.

The trade environment related to the automobile industry seems to become severe; as mentioned above, Vietnam must remove all non-tariff trade barriers, including local content requirements, in exchange for WTO membership. And, at the same time, it is expected to free up mutual trade with ASEAN countries by reducing import tariffs according to the AFTA scheme.

Chapter 3: Lessons from the experience of ASEAN and other Asian countries

An outline of lessons from the experiences of selected ASEAN countries (Thailand, Malaysia and Indonesia) and China and South Korea is summed up below.

· It is worth noticing that **Thailand**'s government made steady efforts in fostering its supporting industry through adoption of step-by-step trade liberalization policy. Of

particular importance is that it made special efforts to attract foreign investments by strengthening investment- and export-incentive measures and by reinforcing measures for human resources provision. Since Vietnam has no lead-time comparable to that which Thailand had, it is important for Vietnam to nurture its supporting industry in the most effective way—in other words, to attract foreign investments in a short period of time by strengthening its investment- and export-incentive measures.

· From the experience of **Malaysia,** it can be said that government efforts in improving infrastructure, ensuring political stability, and selecting the right automobile model at an affordable price would contribute to automobile industry development. On the other hand, a national car project based on protective measures of government, such as Malaysia's Proton project, would infringe upon WTO rules on international trade, and such a closed market would weaken the international competitiveness of the automobile industry and also be very costly.

· The Government of **Indonesia**, since its accession to WTO, has adopted a trade liberalization policy for its automobile industry. However, if Vietnam were to now adopt such rapid and drastic trade liberalization, its economy and businesses would be thrown into confusion, causing a negative impact on protection and promotion of infant industries. Nevertheless, Indonesia's gradual tariff rate system (in which a higher tariff is imposed on CBU relative to car parts, and on car parts relative to materials) for the promotion of supporting industry, offers Vietnam good guidance in terms of its automobile industry policy. Another Indonesian experience that Vietnam should be aware of is that political unrest is detrimental to foreign investment.

· Since **China** was granted entry into the WTO earlier, in 2002, its experience might be beneficial for Vietnam. One lesson from China's experience concerns the importance of thorough government consideration, in advance, of how WTO accession will effect the development of automobile industry. This is especially important since all of the government's protective measures for this infant industry will have to be repealed.

· The Government of **South Korea**, since the Asian currency crisis, has focused on strengthening its local auto parts makers and promoting the accumulation of the supporting industry, in order to increase international competitiveness in those areas. The strategy has been to raise the technology level of the local automobile supporting industry and produce safe and environmentally fit auto parts that meet global standards. For this purpose, the government has been actively inviting foreign capital and making good use of it. In this sense, there is much for Vietnam to learn from the experience of South Korea.

Chapter 4: The orientation of automobile industrial development and policy in Vietnam

PURPOSE AND DIRECTION OF INDUSTRIAL DEVELOPMENT

The Government of Vietnam has recognized the automobile industry as one of the key industries. It is, therefore, essential for Vietnam to find an effective and efficient development path that would both satisfy national demand and benefit the nation as a whole.

It will be increasingly difficult for Vietnam, with its integration into the world economy, to keep implementing protective measures for the development of infant industry. It is important, therefore, for Vietnam to come up with a new and unique automobile development policy that can be called the "Vietnam model," by which the government can most effectively invite and use foreign investments in a short period of time and foster the supporting industry of a particular group of industries. For this purpose, it is indispensable

to make efficient use of the existing joint venture companies while fostering the supporting industry.

As for the production of automobiles, Vietnam must make the best use of the existing joint venture automobile manufacturers and thrust forward with the import substitution measures for the time being. With regard to Vietnam's automobile parts industry, which consists of non-competitive companies, it is of utmost importance that the government makes every effort to foster a uniquely Vietnamese competitiveness by inviting foreign parts makers, encouraging the accumulation of supporting industry for some specific industries, and promoting transfer of technology. For this purpose, the government needs to introduce attractive incentive measures to promote foreign investments. There, however is a need to rationalize them. Incentives should be evaluated on their economic merit, and based on clear and transparent criteria. The overuse of tax incentives sometime risks eroding the tax base for little gain and placing the tax burden on other taxpayers. Identifying such incremental investment and the revenue foregone by investment incentives is an essential starting point in evaluating the economic merits of such subsidies.

CONCLUSSION OF POLICY RECOMMENDATION

1. Preferential measures for FDI

For currently existing automobile manufacturers

Preferential treatment should be given so as to induce the existing automobile manufacturers to make further investments in Vietnam, including investments in supporting industry. As the automobile industry has a strong inter-industry linkage effect and provides greater investment efficiency, it is advisable that government adopt preferential measures (such as tax reduction and extra-depreciation) that would increase the total investment volume of the existing company groups and alliances as a whole.

For newly investing companies

For newly investing companies, the government should improve infrastructure and adopt measures that are more attractive than those provided in other ASEAN countries actively inviting foreign investment. It is important to provide attractive incentives such as tax exemptions; lower tariff rates on import materials and parts; incentives for exports. Vietnam's good reputation among the already invested companies will also attract additional investment. New companies will be attracted to the country as long as the existing companies think highly of the support given by the government. This is the reason that the role of the Ministry of Planning and Investment (MPI) is important

For small- and medium-sized enterprises

Attracting investment by foreign small- and medium-sized enterprises (SMEs) is also very important for promoting the accumulation of supporting industries for the development of Vietnam's automobile industry. Since these small companies usually do not have much capital, preferential treatment must be provided in order to attract them to Vietnam and to promote the accumulation of such companies. For example, the government can consider the use of rent-free industrial parks and idle SOE land and equipment. SMEs should also be permitted to import secondhand machines without import duties for their production lines. They certainly need more favor than large-sized companies do.

For foreign capital parts industry that is strongly desired in Vietnam

Foreign capital parts industry that is strongly desired in Vietnam must also be attracted through preferential treatment. Since ASEAN 4 countries have already succeeded in attracting a large number of foreign parts manufacturers, it is not an easy task for Vietnam to determine which parts are suitable for domestic production and participate in the auto

parts complementation system. Nevertheless, it is still very important for Vietnam to take part in intraregional division of labor for automobile production, and invite foreign parts manufacturers that can supply complementary parts and components to the system. For example, in the areas of leather and cast and forged parts, Vietnam can take advantage of its skilled workers and relatively low labor costs. Other candidates are assembly manufacturing of bulky car parts such as car seats, fuel tanks, exhaust pipes, relatively big resin parts and outer panels; manufacturing of labor-intensive parts such as wire harnesses and antennas, and sewing of car seat covers. In addition to this, manufacture of the component parts (such as small resin parts and small rubber products) for the existing export parts makers in Vietnam as well as production of car parts such as cables and absorbers, which have a considerable synergy effect on the motorbike industry, can also be considered.

Preferential treatment that is incompatible with WTO rules, such as export subsidies, favors for domestic producers, and incentive measures applied discriminatingly to some specific industries in order to attract foreign investment, all become invalid after Vietnam's accession to the WTO. Therefore, Vietnam should consider post-accession introduction of preferential treatment compatible with WTO rules—such as providing duty allowances depending on the value of domestic production, similar to Australia's Automobile Competitiveness and Investment Scheme (ACIS).

4-2-2 Preferential tariff system depending on the production level or assembled parts level

As for the import duties system for KD parts, we recommend that the government introduce a system in which preferential rates are given depending on the assembly and processing levels in Vietnam. A gradual tariff structure (in which progressively lower tariffs are applied for completely assembled cars, KD parts, and raw materials) should also be considered. In addition, the so-called breakdown requirement system (the more the parts are broken down and the more domestic assembly processing is required, the lower the import duty becomes) should be considered and applied at the soonest as possible.

3. Preferential measures to improve local procurement

Vietnam's preferential tariff rates that are given to automobile assemblers relative to the rate of local procurement will infringe upon the WTO rule that requires non-discrimination of domestic and foreign products. Therefore, in order to increase the local procurement quickly, Vietnam must make every effort to invite foreign parts makers and urge domestic assemblers to procure parts from them as much as possible. The government, at the same time, should adopt export promotion measures for such automobile parts makers, whose production would be limited if they would only supply the current domestic market.

4. Human resource development and transfer of technology

Since human resource development will be the key to the progress of Vietnam's future industrialization, the government should consider giving preferential treatment in areas such as training (e.g., exempting the cost from corporate taxation).

A system must be introduced in order to promote technology transfer through FDI-a system in which conformity with international standards is sought through revision of local practices, including royalty payments and technical transfer agreements.

5. Phases for export promotion

The following measures must be considered:

- Allow import of automobiles based on export performance

Using a ban on CBU import and high tarrif to partically block the import of cars in order to expand domestic production are considered essential for automobile industry development in Vietnam. However, such quantitative restrictions are not allowed under WTO and AFTA rules, and the high protective measurs seem to be very costly caused by the high production cost that consumers lose from the high prices, the Government lose potential revenue, while producers lose from sub-optimal scale and high average costs. Vietnam therefore should have to set the midle way to grant export incentives by allow import of automobiles based on CBU export performance. Additionally, the setting of technical or certification regulation or standards (such as for exhaust emission control or for safety) can be also considered in order to restrict inflow of secondhand cars.

- Revising related laws and decrees

  Safety and environment standards must be revised in conformity with international standards, and the current restrictions regarding royalty payments must be abolished.

- Assuring the transparency and consistency of the industrial promotion policy

  In order to promote business activities, rules that are compatible with international standards, clearly explain them externally, and keep transparency and consistency in their applications should be adopt.

From the viewpoint of fostering the supporting industry, it is important to invite not only those foreign parts makers that intend to supply the domestic market, but also those that are export-oriented. For this purpose, export promotion measures such as those listed below are recommended.

- Use of AICO

  The preferential tariff system of AICO should be utilized, so that those auto parts makers that made inroads in Vietnam's market can expand their exports within the ASEAN region by taking part in the automobile parts complementation scheme developed by ASEAN 4 countries.

- Use of CEPT

  As for auto parts, the tariff rate of 0-5 percent should be applied from 2006, as scheduled in the CEPT scheme, in order for auto parts manufacturers to benefit from low tariff rates at their export destination.

- Use of other export promotion measures

  In order to promote auto parts exports, the government should consider developing Free Trade Zones (FTZs) and improved infrastructure.

Chapter 1: The Situation of the Automobile Industry in Vietnam

1-1 The role and merit of automobile industry promotion

1-1-1 Expected merits

The development of an automobile industry is expected to bring about such merits as foreign currency savings acquisition, huge economic effectiveness of investment, potential for a broad range of supporting industry, increase in labor demand, high value added, and facilitation of technology transfer. In order for a developing country at relatively early stages of industrialization to reap these benefits, however, its government needs to support the automobile industry for a certain period of time to develop its competitiveness, as large economies of scale can not be enjoyed while domestic markets are still limited. Such preferential treatment would be approved for these advantages brought about in the future. The automobile industry is one of the keys to the industrialization of Vietnam.

Acquisition of foreign currency savings

One strong advantage in promoting the automobile industry is acquisition of foreign currency savings. As an automobile is a high value added product, import substitution of the industry will contribute to large-scale foreign currency savings in trade revenue. Even at the year 2000 market level, if we assume that all new cars sold in Vietnam had been imported and there were no automobile assembly makers in the country, the trade deficit would have increased by US$127 million (table 1-1). This amount is equivalent to 20.6 percent of the estimated trade deficit in 2000 under this scenario. It also means that if all these cars were to be produced domestically, Vietnam could have saved foreign currency of US$127 million, improving her trade balance of the year greatly.

Table 1-1 Estimation of foreign currency savings (I)

Sales of new cars (2000)	(A) Sales value of new cars US$15,000)	(B) Auto parts import value (2000)	(C) Trade deficit (2000 totaly)	(D) Estimated trade deficit (C)-(B)+(A)	A/D
14,000	US$210 mill.	US$83 mill.	US$892mill.	US$1,019 mill.	20.6%

Calculated from the data of VAMA; *Statistical Yearbook 2000* (General Statistical Office); and General Office of Customs.

It is easy to assume that naturally the more the volume of car sales becomes, the greater the foreign currency savings become, if domestic production substitutes the importing of automobiles. Table 1-2 below shows a projection for car sales in the future and the expected foreign currency savings. One of the specific goals of the Vietnamese government's "Strategy for Socio-Economic Development 2001–2010", is for the 2010 GDP level to be double that of 2000. If we simply double the per capita GDP in 2000 (US$381), the expected per capita GDP in 2010 is US$762 and the automobile sales of Vietnam in 2010 is projected as 104,650 units[1]. Based on this projection, the foreign currency savings are expected to be as much as US$1,569 million in 2010 (assuming the unit price is US$15,000). In other words, if Vietnam were to rely on import for all her automobile purchases, the cost in 2010 alone would be as much as US$1.569 billion.

[1] Regarding this projection, please refer to the section of market trend in Chapter 2.

Table 1-2 Estimation of foreign currency savings (II)

Per capita GDP in 2000*	Expected per capita GDP in 2010	Expected car sales volume in 2010	Expected value of car import in 2010**
US$381	US$762	104,000	US$1,569 million

* Calculated from data of *Statistical Yearbook 2001* (General Statistical Office). Per capita GDP is converted to US dollars at VND15,000/USD.

** Calculated at the assumed unit price of US$15,000. Inflation is not taken into consideration.

Huge economic effectiveness of investment

Foreign investment in the automobile industry usually influences a country's economy rather broadly. The amount of investment in an automobile assembly factory itself is usually huge, and the number of employees becomes large along with the production expansion. Additionally, this is normally followed by investment in related industries, such as automobile parts industry. Furthermore, such investment by suppliers can be expected to trigger investment by second-tier suppliers. The amount of investment by all of these suppliers is often large and they also have considerable potential for job creation. In the course of time, the spreading effect would contribute to the development of the country's industry as a whole.

Take, for example, the case of Toyota Motor Vietnam, whose capital is US$49.1 million (as of June 2001). In line with Toyota's investment, some supplier companies of the Toyota group begin to consider the possibility of investing in Vietnam and some suppliers actually invested after confirming that conditions were right for their investment. As a recent example, Denso, a Toyota group firm, established an engine parts manufacturing subsidiary (Denso Manufacturing Vietnam Co., Ltd.) in October 2001, with total investment of about US$12.5 million.

Potential for broad supporting industry

One automobile unit comprises more than 20,000 parts; thus, the backward linkage effect of the automobile industry is very large, extending to automobile parts and base material industries. The automobile and automobile parts industries trigger high demand in various base material industries; thus, development of automobile industry is expected to promote not only automobile parts industry but also material industries in the long run. Usage of many parts and components to assemble one automobile unit also leads to a high technological linkage. Therefore technological development will be expected through encouragement of the automobile industry.

Furthermore, it can be said that promotion of automobile assembly and automobile parts industries is also beneficial to the industrial sector as a whole. Table 1-3 indicates the strength of the backward linkage in the automobile industry, based on input–output tables of the ASEAN 4 countries and Japan. The inducement coefficient of domestic production indicates the production scale in all industries to be finally induced by production of one automobile. The data shows that even if the localization ratio is under 60 percent, the automobile industry strongly induces domestic production across various industries.

Table 1-3 Comparison of localization levels based on 1975 input–output tables

	Thai.	Indo.	Malay.	Phil.	Japan
(A) Domestic goods input coefficient	41.4	19.8	38.1	41.0	68.3
(B) Intermediary goods input coefficient	73.0	64.4	71.2	73.4	69.0
(C) Localization ratio A/B (%)	56.7	30.7	53.5	55.9	99.0
(D) Inducement coefficient of domestic production	1.64	1.31	1.64	1.71	2.55

Source: Japan Automobile Manufacturers Association, Inc. (quoted in Suehiro and Yasuda ed., *Thai no Kogyoka* [Industrialization of Thailand]).

High value added

Automobile industry and automobile parts industry generate high levels of value added. In regards of some Japanese industries in 1975, the inducement coefficient of gross value added is much higher for transport machinery than for other machinery industries. So this viewpoint, too, shows the importance of the automobile industry.

Table 1-4 Inducement coefficient of gross value-added of some industries in Japan (1975)

	Inducement coefficient of gross value added*
Transport machinery	0.032708
Metal products	0.016525
General machinery	0.024833
Electric machinery	0.023086
Precision machinery	0.004330
Other industrial product manufacturing	0.025356

Source: *1985 Input–Output Tables: Explanatory Report*, Management and Coordination Agency, Government of Japan (March 1989).

* Average coefficient by final demand items.

Increase in labor demand

The potential for employment creation by the automobile industry is considerable. As discussed in the above section, more than 20,000 parts comprise a car, and the backward linkage in the automobile industry is very strong. Thus, the labor demand for the automobile, automobile parts and base material industries altogether is potentially very large. Furthermore, the labor demand for surrounding industries such as car maintenance, car repair and gas stations will increase along with expansion of automobile industry and the market.

Although the automobile industry is a modern industry, it can not be simply said that decreasing labor through automation will bring about higher efficiency. Automation exceeding certain levels will create more inefficiency. The industry still requires a high input of labor; in many processes, work is too complicated for machines and robots and is more efficiently accomplished by humans.

Technology effects

Included among the social effects that the development of the automobile industry would bring about are improved skill levels of technicians and improved technology transfer. Since the automobile industry is a high-technology industry, the skill levels of technicians in the industry are expected to improve through engagement in the production process. The automobile industry involves heavy machinery, machine tools and automation systems in its production processes, as well as the application of many new technologies; thus, technicians can acquire advanced technology through working in the production of automobiles. Concurrently, a high level of technology transfer to other industries can be expected, along with the transfer of accumulated skills to other industries. This will contribute to improving the overall technological level of Vietnamese technicians. From this perspective, it can be said that inviting foreign invested automobile and automobile parts companies would be beneficial to industry as a whole. Such foreign automobile and automobile parts companies would generate positive external effect on local companies and accordingly would be expected to contribute to enhancement of the overall industry base of the country. Development of automobile industry also contributes to reduction in social costs, such as transport costs and distribution costs.

1-1-2 Comparison of short-term and long-term merits

As shown in table 1-5 below, the extent and influence of the long-term merits are very large and significant for the Vietnamese industry and economy as a whole. It takes long-term commitment to the industry development, however, for the long-term merits to be realized. Therefore, once the government decides to promote the automobile industry, it needs to consistently implement development policy and measures for a certain period of time in order to achieve successful industry development and to benefit from these long-term merits.

Table 1-5 Comparison of short-term and long-term merits

	Short-term merits	Long-term merits
Foreign currency savings	· At the level of year 2000, about US$127 million in foreign currency savings will be acquired; this is equivalent to about 20.6% of the trade deficit in 2000.	· About US$1.5 billion in foreign currency savings will be acquired for the year 2010. This benefit will become greater in subsequent years, along with the progress of motorization.
Economic effectiveness of investment	· An economic spillover effect is expected to arise from initial investment in land leasing, factory construction, etc. · Distribution of goods will be activated due to the start of production.	· Investment by an automobile assembly firm might trigger subsequent investment by supplier firms and base material companies, creating a huge amount of capital and considerable potential for job creation. This spreading effect would contribute to the development of the country's industry as a whole.
Potential for broad supporting industry	· Investment, mainly foreign direct investment, in auto related industries will be increased in the short run.	· Auto parts industry will gradually grow along with the progress in automobile industry development; and the localization rate will be raised accordingly. · Development of base material industry will be encouraged according to the growth in the automobile industry and auto-parts industry.
Increase in labor demand	· Job creation is expected: the new FDI firms will be hiring employees for their newly constructed factories.	· The number of employees at auto manufacturing factories will increase along with expansion of automobile production. · Development of auto parts industry as well as materials industry will necessitate great increases in the labor forces in those industries.
Technology effects	· New technology will be brought in along with introduction of new production methods and equipment through foreign investment.	· Skill levels of technicians will be improved through working in the industry. · The overall industry base of the country will be enhanced by the positive external effect on other industries.

1-2 The situation of the automobile industry in Vietnam

1-2-1 Current situation of the automobile industry in Vietnam

The Vietnamese automobile industry consists of eleven joint-venture companies (with foreign direct investment) and local companies. Table 1-6 lists the automobile assembly makers operating in Vietnam as of Dec. 2004, showing their production start dates, capital composition, production capacities and sales in 2004.

Current situation of joint venture companies

(i) Investment capital

Fourteen foreign direct investment companies were licensed for automobile assembly between 1992 and 1997, and currently eleven of them are operating[2]. As of Dec. 2004, total registered investment capital of the eleven joint-venture firms was US$543,429,000, whereas their aggregate investment in this industry was US$326,813,000, realizing 60.13% of the registered capital[3].

(ii) Production capacity and employment

Total production capacity (at time of registration) was 148,900 units per year, and as of December 2004, total sales volume was 167,448 units. Total Employment of the eleven joint-venture companies is 2,972 persons, including 59 expatriates.

(iii) Level of management and level of technology

The market's limited size poses an obstacle to expanding production volume, but foreign investors value the dexterity and high productivity of Vietnamese workers. For example, defect rates at joint venture auto and auto parts factories have been low. Furthermore there is a move to introduce a new production method that makes better use of such strengths of Vietnamese workers. For example, TMV announced that in 2003 it would introduce an innovative production method in its pressing procedure. Conventionally this procedure requires four presses, but the new method uses only one machine. The work of these machines, when combined with that of the skilled Vietnamese workers, will enable high product quality to be maintained, while contributing to cost reduction. Vietnam is the first country to introduce this method[4]. Thus Vietnam's apparent capacity in physical labor capacity is heightening expectations of improvement in managerial and technological aspects, along with her market expansion and increase in production volume.

(iv) Sales

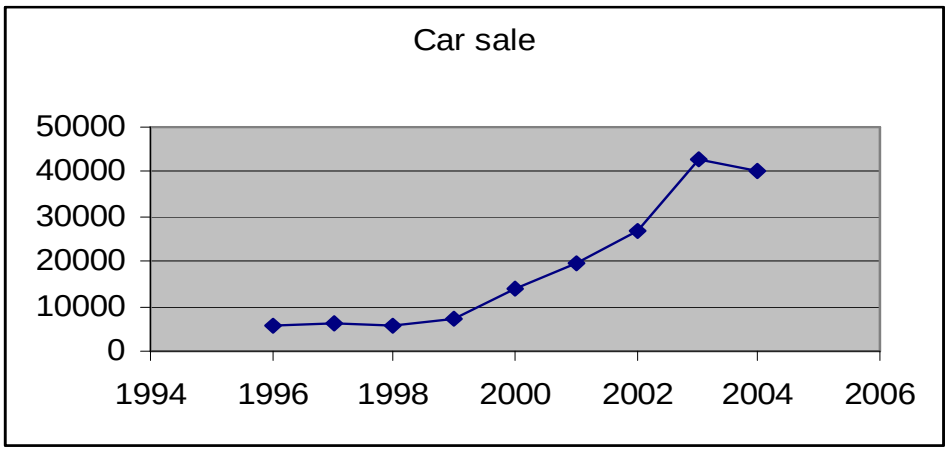
Chart 1-2 shows the market share of joint venture automobile companies in 2004. The market size for the industry is still small, about 40,000 in 2004; thus, even the largest share (24%) represented sales of about 10,000.

[2] Consideration of license applications for automobile assembly plants has been suspended (as of May 2002) until 2010 (the announcement of this decision was made in May 2002 and applications already submitted are to be decided by the prime minister). "Brakes put on licensing of auto assembly firms", *Vietnam Investment Review* (May 20-26, 2002).

[3] The registered capital and invested capital include Suzuki's investment in its motorcycle business.

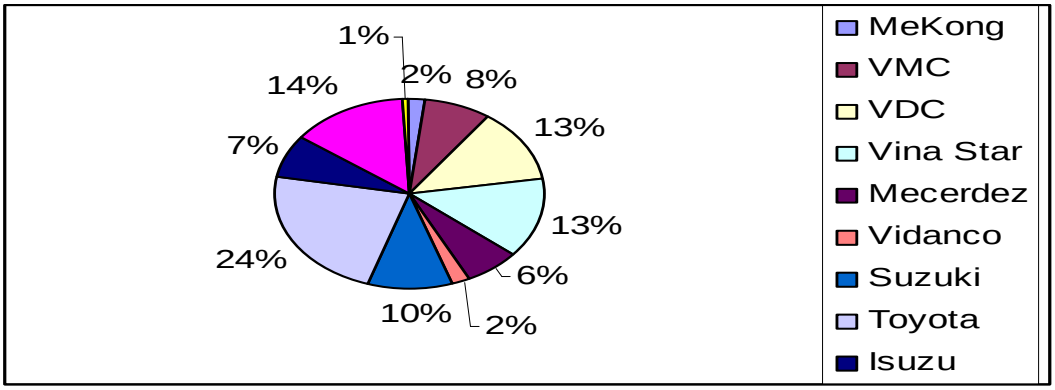
[4] Based on statement of the president of Toyota Motor Vietnam Co., Ltd. (April 2002).

Chat 1-1 Automobiles Sales by Joint Venture Companies



Source: based on information of VAMA.

Chat 1-2 Market share of Joint Venture automobil companies in 2004



Source: based on information of VAMA

(v) Operation

The eleven joint-venture companies are engaged in assembly, either CKD 1 type (painting and assembling lines) or CKD 2 type (including painting and welding lines). Thus the companies' equipment investments are all similar, mainly consisting of welding lines, cleaning and painting lines (some joint-venture companies invested in static painting lines), and assembling lines (including test equipment).

All joint-venture companies are supposed to transfer technologies, but this is happening only to a limited extent, mainly for CKD 2 assembly lines. The permitted duration of technical transfer contracts is only seven years at maximum, which is restrictive. The joint venture companies also must abide by a rule on local content requirements[5]. Efforts have been made on the assembly maker side, but still the localization rate is low, especially for passenger vehicles, due to the small production volume and limited availability of domestic suppliers.

[5] "After five years have elapsed since starting production, joint-venture companies must use parts and components produced in Vietnam to the extent that local content is no less than 5 percent of the total value of the vehicle, and steadily increase the local content in order to reach a 30 percent minimum in the tenth year." (Circular 215/UB/LXXT issued on 8 February 1995 guiding the investment for automobile industry).

Current situation of local companies

There are three projects by state-owned companies to produce commercial vehicles, such as buses and trucks, in response to the non-luxury vehicle program. According to the Vietnamese government, they use imported components, their local content ratio is considered to be over 40 percent in the first year of production and they are expecting to procure other components such as engines and transmissions domestically in the future. Domestic production of low-priced passenger vehicles by local manufacturers is also being considered[6].

1-2-2 Automobile industry policy in Vietnam

The Vietnamese government recognizes the importance of promoting automobile industry and is determined to proactively develop it as one of six key industries. The government has targeted 2010–2015 both for complete import substitution in the main vehicle categories of automobile industry and for gradual movement into the export of automobile parts, components and non-luxury vehicles to other countries[7]. For the years up to 2010, the government plans for the industry to meet 40 percent of domestic demand, enhance the localization ratio up to 60–70 percent, increase investment in production of auto engines, and make efforts toward achieving a Vietnamese trademarked vehicle.[8]

Coherent policy for automobile industry development is yet to be formulated, although it has been examined and discussed at cross-ministerial settings. In order to attain the above targets, development policy must be consistently implemented and underscored by the government's strong commitment, based on the consultation among policymakers of related ministries and agencies.

[6]; 7 Vietnam Ministry of Industry and Institute for Industry Policy and Strategy, "Orientation of Vietnamese Automotive Industry", April 23, 2002.

[8] In the "5-year Plan for Socio-Economic Development (2001-2005)", the Vietnamese government mentions that "40-60 percent of the auto accessories will be produced domestically. Investment for production of auto engines is to be enhanced while simultaneously striving to have automobile and motorbikes products (firstly buses and trucks) sold with a Vietnamese trademark". Also, the "Strategy for Socio-Economic Development 2001-2010" states that "mechanical engineering is to satisfy 40 percent of the domestic needs, with local content accounting for 60-70 percent of the total for motor vehicles".

Table 1-6 Current situation of joint-venture automobile companies in Vietnam

Company name	Start of production (establishment)	Capital composition	Production Capacity[9] (units)	Sales (units, 2001)
Mekong Auto	1992	Saelio Machinery Japan 51%, VEAM 30%, Sae Young Int'l 19%	30,000	737
Vietnam Motors Corp.	1992	Columbian Motors 55%, Nhamay oto Hoa Binh 30%, Nichimen Co. 15%	20,000	3279
Vietnam Daewoo Motor Co., Ltd.	January 1995	Daewoo Motor 100%	20,000	5112
Vina Star Motors Corporation	March 1995	Mitsubishi Motors 25%, Mitsubishi Co. 25%, Proton 25%, Vietrans-cimex 25%	20,000	5384
Vietindo Daihatsu Automotive Corp.	May 1996	Daihatsu 26%, Transport Industry 33%, Astra Int'l 26%, Mitra Andasantika 26%, Kanematsu Co. 2%	8,400	813
Mercedes Benz Vietnam Ltd.	August 1996	D-Benz Vietnam Investments 70%, SAMCO 25%, Auto-Plant 1st May 5%	11,000	2602
Toyota Motor Vietnam Co., Ltd.	August 1996	Toyota 70%, VEAM 20%, Kuo 10%	5,000 (1 shift)	9150
Vietnam Suzuki Corp.	November 1996	Suzuki 35%, Nissho Iwai Co. 35%, VEAM 30%	12,400	4094
Isuzu Vietnam Co., Ltd.	1997	Isuzu 35%, Itochu Co. 35%, local company 30%	2,000	2963
Hino Motors Vietnam Ltd.	November 1997	Hino Motors 51%, Automobile Repairing Factory No.1 33%, Sumitomo Co. 16%	1,000	389
Ford Vietnam Ltd.	November 1997	Ford 75%, Song Cong Diesel 25%	7,000	5618

Source: VAMA and FOURIN "2002 *nen Ajia Jidousha Sangyo*" (Asian Automobile Industry in 2002)

[9] Production capacity is the future capacity plan at the time of investment application (assuming 2-shift, full operation) and is not the actual production capacity.

Chapter 2: Factors that Influence the Automobile Industry in Vietnam

2-1 Situation of domestic demand

2-1-1 Trend of sales volume

Relationship between car price and sales for automobiles in Vietnam

In 2003, the eleven automobile manufacturers recorded total sales of 42,556 units, a 58% increase from the previous year. The main reason for this record achievement is growth in corporate demand, due to the corporate law enacted in January 2000, which led to both an increase in the number of newly registered companies, along with development of industrial infrastructure. In 2004 the total sales reached 40,141 unit, there was a 5.8% slight change negatively due to the increase of special consumption tax for auto vehicles imposed by the SCT Law. However, in both years, there was puchasing trend caused by the increasing of car prices for the next comming year.

Car demand has increased greatly over the last two years and the variety of cars is expanding. It might be said that the automobile industry in Vietnam began to develop in 1999. For the last ten years, since the first assembly maker invested in Vietnam, the Vietnamese market has not expanded and some argue that expected significant effects have not taken place yet. However, the development between 2001-2010 is very important for further growth in the following decade starting in 2010.

Table 2-1 Automobile sales, by companies *(unit)*

Company	1996	1997	1998	1999	2000	2001	2002	2003	2004
Toyota	201	1,277	1,836	2,179	4,600	5,759	7335	11769	9150
Dae-GM	1,014	689	465	1,097	1,750	2,906	3719	5,349	5112
Ford		11	362	325	1,195	1,915	3685	5,243	5618
Mercedes	71	359	252	183	547	1,874	2622	3,375	2602
VMC	2,09	1,341	950	1,25	2,222	1,8	2524	15,68	3279
Misubishi	.482	622	702	650	858	1,612	2440	4,877	5384
Suzuki	161	489	386	320	948	1,508	2122	2923	4094
Mekong	.964	527	417	281	414	866	907	16,68	737
Isuzu		57	148	200	483	744	870	1878	2963
Daihatshu	555	556	345	434	779	469	492	1039	813
Hino		12	64	44	81	103	156	199	389
Total	5,538	5,94	5,927	6,963	13,955	19,556	26872	42,556	40,141

Source: VAMA.

The auto sales in Viet Nam market has been increased over the last ten years. To quantitative policy effect, through the change of sale volume caused by price change, we assume that the change of price lead to a change of sale volume follow the model:

(The method can be seen at Chapter 13 Introductory Econometric A Modern Approach, 2e Jeffrey M. Wooldridge Michigan State University)

$$\log(sale_{it}) = (\beta_0 + \delta_0) + \beta_1 \log(price_{it}) + a_i + \varepsilon_{it}$$ where:

- sale is the sale and price are volumes and;

- prices for each model respectively in each period;
- a_i is the unmeasured constant error over time;
- ε_{it} is an estimate error,

For each period of years 2003 and 2004, we have:

$\log(sale04_i) = (\beta_0 + \delta_0) + \beta_1 \log(price04_i) + a_i + \varepsilon_i$ (year 2004)

$\log(sale03_i) = \beta_0 + \beta_1 \log(price03_i) + a_i + \varepsilon_i$ (year 2003)

We subtract the second equation from the first, we obtain:

$$\Delta\log(sale_i) = \delta_0 + \beta_1 \Delta\log(price_i) + \Delta\varepsilon_i$$

Where: "Δ" denoted the change from year 2003 to year 2004; with the unobserved effect.

Using the breakdown data of each model sales in the period 2003-2004, we can analysis the causual effect of price increasing to the sale volume that we have an estimate equation:

$$\mathbf{\Delta\log(sale_i) = 0.1 - 3.76\,\Delta\log(price_i)}$$

Source	SS	df	MS	Number of obs =54*
				F(1, 52) = 8.79
Model	7.471194	1	7.471194	Prob > F = 0.0046
Residual	44.17853	52	0.849587	R-squared = 0.1447
				Adj R-squared = 0.1282
Total	51.64973	53	0.974523	Root MSE = 0.92173

:

Δlog(sale$_i$)	Coef.	Std. Err.	t	P>t	[95% Conf. Interval]	
Δlog(price$_i$	-3.75966	1.267821	-2.97	0.005	-6.30373	-1.21559
_cons	0.106422	0.166817	0.64	0.526	-0.22832	0.441165

The coefficient $\beta_1 = -3.76$ with very small p-value, statistically significant at 95%, allows us to say that between the two years (2003-2004), if the price decrease 1% then sale volume could increasingly change by 3.76%, and if there is no change in price with conditions in year 2004 as same as in year 2003, car sale will by increase by 0.1%.

Car sales categorized by type tell us that, in particular, compact and medium size cars, and commuter vans are increasingly popular in Vietnam. The relationship between car price and sales volume for automobiles in Vietnam (Adj R-squared = 0.1282) tells us that price is not the only reason for low car sales. Elements such as after-sales service, design and comfortability should be also taken into account in the purchase decision.

The auto market trend

To analysis the auto market trend, we assume that the change of sales caused by the change of the per capita GDP of time series:

$sale\_1000_i = \beta_0 + \beta_1 capita_i + t + \varepsilon_i$; where:

- $sale\_1000_i$ is the car sale per 1000 people in Viet Nam each year over period (1996-2004);
- capita is per capita GDP of every year respectively, t is time variable;

- ε_i is estimated error.

Using Stata to analysis time series of sale_1000$_i$ in the period 1996-2004, we have:

Source	SS	df	MS	Number of obs = 9
				F(1, 7) = .
Model	0.222502	1	0.222502	Prob > F = 0
Residual	4.66E-15	7	6.66E-16	R-squared = 1
				Adj R-squared = 1
Total	0.222502	8	0.027813	Root MSE = 2.60E-08

sale_per10~t	Coef.	Std. Err.	t	P>t	[95% Conf. Interval]	
capita_hat	0.002638	1.44E-10	.	0	0.002638	0.002638
_cons	-0.85521	6.02E-08	.	0	-0.85522	-0.85521

The result regression shows the relationship between per capita GDP and automobile sales. Using time series data over the period 1996-2004. The spread of automobile usage and the progress of economic development in a country seem to be very closely related, In 2005, the its per capita GDP in Viet Nam is about US$ 545. Then the market demand was estimated about 48.000 units (with the population is about 82 mill.). However, the price has increased (about 12% calculated by average change of all car models, which have been sale in Viet Nam) due to the change of tariff and SCT, the sale volume therefore get loses, and get 40.141 units only.

Demand projection by 2010

By 2010, the Vietnamese government wants its per capita GDP to be double that of 2000. If we assume that this goal will be realized and simply double the per capita GDP in 2000 (US$381), then the per capita GDP is expected to be US$762 in 2010. Using the regression analysis of relationship between per capita GDP and automobile sales per 1,000 persons as mentioned above, the automobile sales per 1,000 persons of Vietnam in 2010 is estimated to be 1.15. According to the projection by the General Statistical Office of Vietnam, the population in 2010 is projected to be 91 mill.. Thus the automobile demand in 2010 is projected to be about 104,650 (table 2-2), if the retail price and tax structure for automobiles remains the same.

Table 2-2 Projection of automobile demand (2010)

Per capita GDP (2000)	Projected per capita GDP (2010)	Projected population (2010)	Projected automobile sales per 1,000 persons (2010)	Projected automobile demand (2010)
US$ 381	US$ 762	91 mill.	1.15	104,650

2-1-2 Features of auto market demand:

Car prices in Vietnam are high, according to the JETRO survey, the price of 1500cc sedan in the capital city as of late 2003 is as follows: Vietnam ($26,500), Indonesia ($18,801), China ($16,310), Taiwan ($14,802), Malaysia ($13,965), Philippines ($13,511), Thailand

($12,663), and Korea ($10,365). Meanwhile, Myanmar ($44,000, second-hand model), Singapore ($41,841) and Bangladesh ($30,524) report higher prices than Vietnam.

The unit price of automobiles is high in Vietnam because the late introduction of automobile industry promotion policy and low domestic production volume, which prevented manufacturers from enjoying economies of scale and caused them to rely on expensive imports—the latter a result of high customs duties on most material parts.

Shown below is a price comparison table for Toyota Corollas in Vietnam and Thailand. In comparison between Vietnam and Thailand, retail price of Corolla Altis is US$25,500 in Vietnam, while US$22,000 in Thailand. While not the only reasons (as was indicated above) the small market size and undeveloped supporting industries are construed to be major factors in the higher prices in Vietnam. As shown in table 2-4 and chart 2-2, production volume of the Corolla Altis in Vietnam and in Thailand were 1,019 and 18,500 respectively. In addition, while there are more than 1,000 suppliers in Thailand, there are only 49 suppliers in Vietnam. Assembly makers in Vietnam are relying on imports for parts and materials with low economies of scale, which results in higher retail prices.

Table 2-3 Price and production volume comparison of Toyota Corolla in Vietnam and Thailand

	Vietnam	Thailand
Retail Price	US$25,500	US$22,000
Price after reduction of VAT, SCT, etc.	US$21,500	US$14,800

Sources: JAMA, VAMA (2002).

In Vietnam, high economic growth is continuing and the per capita GDP will double in ten years to about $800 (according to the 10-year socio-economic plan). Event at that level, it will still be difficult for average income earning people to buy cars. However, per capita GDP in urban areas will be more than $2000, and the demand for cars there will dramatically increase for not only business use but also private use if the price is not too high.

The poor situation of infrastructure in Vietnam is another reason for the lack of increase in car demand. Policy on roadways, parking space and other traffic related infrastructure would influence car demand. Improvement in such infrastructure would increase car demand, and motorization would take off. In addition the increase in the establishment of new private companies and the urban expansion–induced increase in the building of houses in rural areas would produce strong demand for cars.

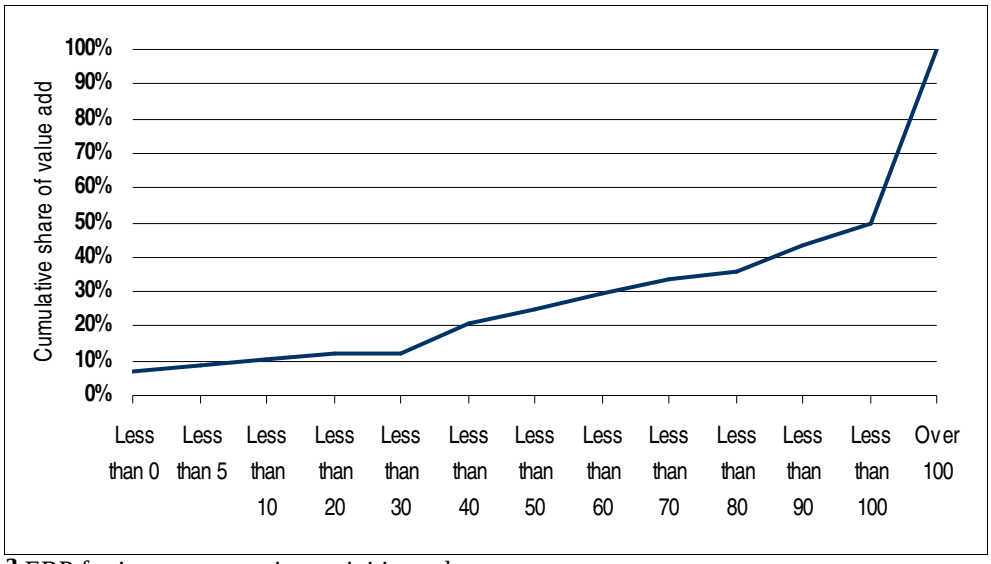
2-2 Protection Policy

2-2-1 Dependence on protection

Chart 2-4 is a distribution of value added for manufacturing activities. It presents an indication of the how much labour, land and capital is currently utilised in import substituting activities with different levels of protection. It shows that a little over 10 per cent of manufacturing value added is in activities with ERPs less than 30 per cent, while around 50 per cent is in activities with ERPs over 100 per cent.

Chart 2-4

Cumulative distribution of industrial value added in I/O industries, by ERP[a]

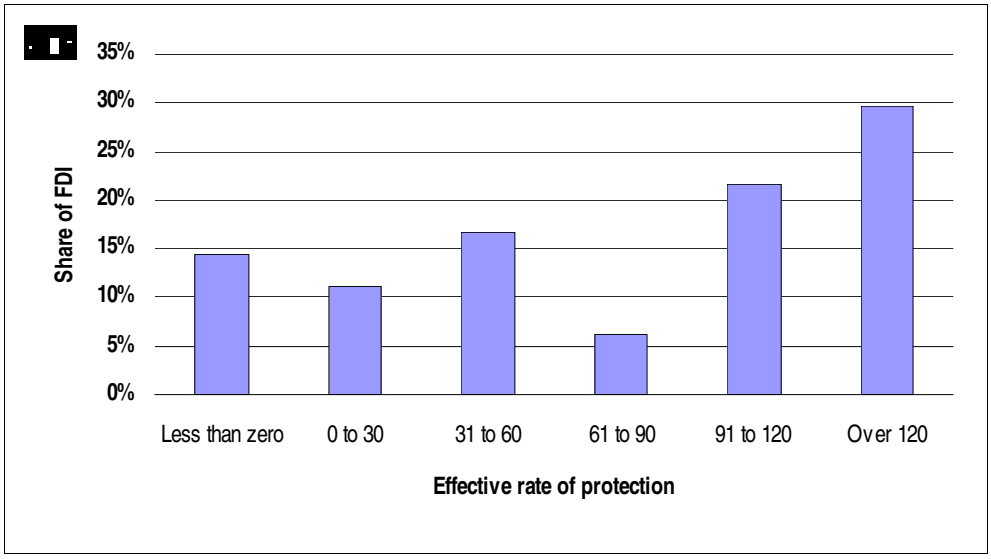


a ERP for import competing activities only.

(The effective rate of protection measures the combined impact on value added in a production process of tariffs (or import restrictions) on imports that compete with domestic output, and on importable inputs. A high effective rate or protection suggests that the value of land, labour and capital services used in production of a unit or output is much larger than it would be if all tariffs and import restrictions were removed. The effective rate of protection is defined as the percentage change in producers value added, as a result of tax on trade, over the level of value added that would have prevailed in the absence of those taxes.)

Data source: CIE calculations.

Chart 2-5 Much FDI has been in sectors with high levels of protection



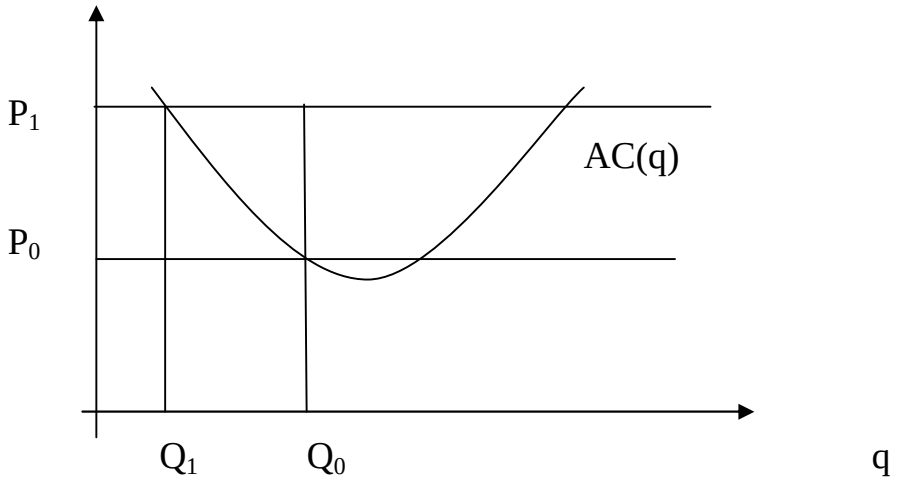
Source: CIE 2000

A particular issue is that a significant proportion of investment by foreign investors and state enterprise is being targeted to capital intensive activities that are dependent on high levels of protection against imports. Chart 2-5 shows that over 50 per cent of recent foreign direct investment has been in sectors with ERPs over 90 per cent and a quarter is in sectors with ERPs over 120 per cent. It seems likely that many of the areas for industrial investment proposed in the Socio-Economic Development Strategy 2001-2010 —for example heavy industries such as steel, aluminium, precious metals, basic chemicals,

fertilisers, construction materials —will almost certainly also require fairly high levels of protection for projects to be financially viable.

The automobile industry is characterized by considerable economies of scale. As is shown in Figure 2-6, the firms face a downward sloping average cost (AC) curve. The high rate of protection on automobiles initially allows auto-makers to sell products at high prices at P_1 and assembly at Q_0. The initial firms are extremely profitable due to the protection, and this profitability attracts additional entrants. Firms continue to enter until each firm is operating at sub-optimal scale at Q_1 (it can be seen in the case that Honda has applied and got the license to assembly cars and vehicles in early 2005, even most of auto-makers are running in half of assembling capacity). Given the strong scale economies prevailing in this industry, the small output level of the firms pushes up their average costs. The rise in average costs eventually eliminate all excess profits and hence removes the initiative for additional firms to enter, until a new equilibrium is reached where excess profits are zero.

Figure 2-6 Relation between Cost and Quantity in the protective environment



The high rate of protection on auto industry initially attracted fourteen foreign auto-makers such as Toyota, Ford... to set up joint ventures in Viet Nam. However, high protection resulted in high production costs, rather than high profit.

These policies are likely to be costly. Consumers lose from the high prices, The Government lose potential revenue, while producers lose from sub-optimal scale and high average costs. The industry continues to lobby for further increases in protection given the high cost of production. When it is succesful, a short period of increased profitability follows, until the benefits are reduced by additional entry. Then, profits are again at normal level and the cycle of lobbying starts over again.

2-2-2 The necessity of international competitiveness

Considering the global economy, it is necessary for the Vietnamese automobile industry to acquire international competitiveness in the short term. An increase in production of a few car types is one strategy for manufacturers in order to enjoy economies of scale. However, the domestic demand in Vietnam is diverse and the production should be set to meet them. In this situation Vietnam's domestic automobile industry will encounter short-term difficulties in terms of international competitiveness. The movement of economic globalization is rapidly proceeding and there is little time to promote an infant industry.

Assistance to automobile industry will engender the development of supporting industries, such as parts makers, and improved technology, positive developments that are not possible without the adoption of supporting policy.

Vietnam does not have the supporting industry required to be able to produce cars locally. In many cases, it is said that complete knockdown products are simply imported from overseas and assembled. If supporting industries are not promoted, automobile industry will never take root in Vietnam.

It is important to think of promotion of automobile industry including parts in Vietnam that is, promotion from two viewpoints: that of automobile assembly industry and that of supporting industry.

2-3 Changes in the Trade Environment

Increasing economic globalization and market penetration along with the recognition of AFTA and WTO rules make it difficult for Vietnam to adopt protective industrial policy to promote automobile industry. Regional integration is progressing and the markets for more and more goods are becoming borderless.

Accession to the WTO and economic integration will mean that Vietnam will join nearly 150 countries that embrace the following principles:

- non-discrimination — that is, according all members of WTO the same, Most Favoured Nation status (with some exceptions regarding WTO compliant regional trading agreements), and not discriminating between domestic and foreign products, services or nationals;
- reducing barriers to trade, through processes of negotiation;
- increasing predictability of trade policies by binding commitments to opening markets and reducing barriers; and
- limiting use of non-tariff trade instruments.

Vietnam will be required to prepare and negotiate schedules of commitments relating to:

- tariffs (to be reduced and bound or subject to ceiling bindings) and other measures affecting trade in goods;
- market access, domestic support and export subsidies affecting agricultural trade (with bindings); and
- commitments on trade in services, consistent with the General Agreement on Trade in Services.

These schedules may specify phase-in periods and temporary maintenance of current practices. It is likely that Vietnam will be required to undertake commitments that are not currently required of existing members of WTO.

And then, implications for industry

WTO accession will clearly bring important changes for all sectors of the economy. For industry, the actions that will have the most important immediate effect are likely to be:

- tariffication of many non-tariff barriers, especially import bans and quotas which are solely protective in intent;
- making a commitment on binding of industrial tariffs;
- amending trade related investment measures inconsistent with the Agreement on Trade Related Investment Measures reached during the Uruguay Round — this is likely to require extension of national treatment, and phasing out elements of foreign investment regulations conditional on export performance, import patterns or local content;

- reducing state support to state trading enterprises and other state owned enterprises — this may require corporatisation or even privatisation of commercially oriented enterprises;
- implementing national treatment with respect to all indirect taxes, notably the special consumption tax.

The main upshot of making commitments on these fronts will be a strong limitation on the use of taxes and controls on imports to assist some local producers (and by implication to tax other producers). Viet Nam will also have to forego the use of provisions in the current laws on investment to encourage exports and achieve local content objectives. This will have significant implications for the pursuit of the government's current industrialisation objectives.

2-3-1 Conditions of AFTA

Upon joining ASEAN in 1995, Vietnam automatically became a member of the ASEAN Free Trade Area (AFTA) in January 1996. By January 2006 Vietnam will have implemented the Common Effective Preferential Tariff (CEPT) scheme for freeing up mutual trade with other AFTA countries on all products with an ASEAN content of more than 40 percent. CEPT provides for freed-up trade, removal of non-tariff barriers, and reduction of import duties to 0–5 percent.

As ASEAN member countries can decide to which list[10] each item type is assigned, the Vietnamese government has applied to the ASEAN council to have passenger cars seating 15 or fewer passengers assigned to the GEL. In contrast, Thailand and Indonesia have already listed automobiles and related parts on the IL.

CBU import restriction and the tax exemption for domestically produced cars are matters of the highest priority in the short-term strategy for automobile industry promotion. Second in importance is the networking of parts industry in ASEAN. By using the ASEAN Industrial Cooperation (AICO) scheme, the automobile parts industry network will be realized and the cost of automobile parts will be reduced. AICO preempts CEPT in establishing a tariff level of 0–5 percent on particular items for trade between two or more countries, but is only applicable to "items not listed on the CEPT GEL". Participation in AICO will attract export-capable parts makers to Vietnam. In practice, there are competitive large-scale parts makers that want to operate under AICO conditions in order to set up local operations.

Car manufacturers in ASEAN countries have started developing automobile parts complementation schemes in order to achieve economies of scale for a unified market, thereby decreasing per-unit production costs. This trend in optimizing the production of automobile parts through ASEAN market integration took hold after the Asian economic crisis and will only accelerate in the future. Given the realization of trade liberalization within ASEAN under the scheme of AFTA and future strictures in line with WTO rules, finding leeway for local content policy is becoming increasingly difficult.

Within ASEAN, Thailand is expected to maintain its top position in the automobile industry in terms of local market size and concentration of supporting industries and to become a hub of automobile production. However, if parts production and CBU assembly are concentrated in Thailand, trade imbalance will occur. To address this, Thai, Malaysian, Indonesian and Philippine product operations are being integrated considerably. Although

[10] Under CEPT, most products are listed on either the inclusion list (IL) or the temporary exclusion list (TEL), with exceptional commodities listed either on the general exemption list (GEL) or on the sensitive list (SL) for unprocessed agricultural products.

this scheme is almost complete, Vietnam should try to become a part of it.

2-3-2 Conditions of the WTO

In 1994, Vietnam applied for membership in the World Trade Organization (WTO), whose purpose is the realization of liberalization, equality, non-discrimination, and mutual benefit in global trade. At this moment it is not clear when Vietnam will become a WTO member, but it is expected that Vietnam will join the WTO by end of year 2005. The requirements of non-discrimination between foreign and domestic products and elimination of quantitative restrictions are thorns in the sides of developing countries such as Vietnam, because in order to promote strategic industries in developing countries, some protective policies are inevitably necessary. After the WTO accession, import duty is the only measure for protective policy. Article XVIII of GATT (Exceptional Measures on Accession for Countries in the Early Stages of Development) provides assistance for developing countries by permitting them to employ quantitative restrictions designed to cope with trade deficits or protect infant industries. However, protection of infant industries is approved only through case-by-case negotiation. Generally speaking, considering experiences of other countries' negotiation, such as China's, it seems highly unlikely to get approval for application of GATT Article XVIII.

Thus before joining the WTO, Vietnam has to adopt strategic and concentrated on promotion policy.

Difficulties of using direct Government subsidies due to the SCM Agreement

Export promotion, market development, Export finance, including subsidized credit, guarantees and insurance, are clearly a prohibited export subsidies on industrial products under the ASCM, unless the OECD arrangements are applied. However, most members provide such support, and hence its likelihood of challenge is minimal unless significant assistance is provided to competitiveness Vietnamese exports.

Other domestic industrial subsidies are in principle actionable for removal by trading partners subject to "adverse effects." Moreover, only two of the three types of such effects, namely injury, and nullification and impairment, and not "serious prejudice", can be invoked against developing countries, such as Vietnam. This may well lessen the likelihood of such challenge, although it is likely to be slim in any event unless Vietnamese subsidization becomes much more significant for competitive exports.

If we reflect the WTO system through the famous "traffic light" analogy for subsidy disciplines, the current situation of subsidy traffics looks quite messy. All green lights for subsidy roads were taken off from the traffic signals, leaving only red and yellow lights. Most of subsidy traffics are either jammed at read lights or risking their lives to venture passing at yellow lights. This systemic fracture for subsidy disciplines has caused considerable uncertainty not only to WTO Members' government sectors but also to private business community when they cannot assure the legitimacy of the governmental policies under which they are sometimes vastly affected until the trade or economic effects of the policies are assessed only based on other Members'circumstances.

Thus, the WTO rules are considered as to provide a limitation of scope to apply domestic subsidies. Their application, however, should be evaluated using an economic framework to determine whether such subsidies are economically desirable. Just because they are WTO consistent is itself no rationale for using them. Subsidies are best assessed like other forms of assistance on whether they are consistent with efficient resource allocation. If they encourage resources to flow into subsidized products or activities from lowly assisted

and more efficient uses, they can reduce national welfare and should be removed. Subsidies providing “needs” based assistance are unlikely to be consistent with efficiency, and transparency. Tax and financial systems should therfore be rarely and foxy used to the extent possible to meet industrial policy objectives or to deliver industry assistance.

2-3-3 Conditions of the Vietnam–US bilateral trade agreement

In December 2001 the Vietnam–US bilateral trade agreement (BTA) came into effect. This agreement will bring an increase in trade, investment and economic cooperation between the two countries.

From the viewpoint of trade, Vietnam receives most favored nation status from the US. The US market, void of non-tariff barriers, is opened to Vietnamese exports. It is expected that Vietnam not only will increase its exporting to the US but also will receive FDI from US and other countries’ firms that are targeting the US market.

Adoption of international standards for the protection of intellectual property is crucial in order to attract FDI. The above-mentioned BTA is expected to improve market access and the investment environment. Deregulation, especially in the service industry market, will have a good effect on investment in all industries. As for the investment environment, regulations that do not comply with the WTO’s trade-related investment measures (TRIMs) agreement will be abolished and protection of intellectual property is expected.

However, from the viewpoint of promoting automobile industry, there are some problems in this agreement. The first is the treatment of special consumption tax. At present domestically assembled cars receive deduction of the SCT and this is counter to the WTO national treatment rule. Although this exception to national treatment is admitted by the agreement, it is agreed that it is to be eliminated within three years from the entry into force of the agreement. The use of SCT to promote domestic assembly cars is discriminatory and must be abolished.

From the viewpoint of developing industries, it may be impossible for Vietnam to adopt protective policies, as Vietnam must treat US products and providers on a non-discriminatory basis, and must phase out TRIMs toward US companies by November 2006, if Vietnam has not acceded to WTO until then. The Vietnam-US BTA places many requirements on Vietnam—for example, protection of intellectual property, deregulation of service industry and a phasing out of TRIMs. And in particular, the intellectual property rights and investment requirements in the Vietnam-US BTA are stricter than those of the WTO.

2-3-4 ASEAN countries’ situations, and policies corresponding to them

The WTO’s TRIM agreement cites local content and foreign currency procurement requirements as examples of non-tariff trade barriers. Developing countries must remove all non-tariff trade barriers, including local content requirements, within five years of the enactment of the TRIM agreement. Vietnam’s automobile industry will be subject to this upon the country’s accession to the WTO.

Among the Asia Free Trade Area signatories, Singapore, Brunei Darussalam, Indonesia, Thailand, and the Philippines all agreed to abide with CEPT rules and reduce intra-regional duties to 0–5 percent, beginning January 2003. Malaysia, in contrast, fearing adverse affects from removing protection for its national cars (Proton and Perodua), used the occasion of the May 2000 ASEAN economic ministers conference in Yangon to apply for

a grace period (to January 2005) for automobile-related items. This postponement was approved at an ASEAN conference held in Chiang Mai. In return for the postponement, Malaysia agreed to compensate Thailand and Indonesia for losses that the postponement causes them.

The ASEAN region will become a free trade area from January 2003. At this point, only those countries abiding by free trade requirements will be able to reap the attending benefits. ASEAN membership is founded on the principle of reciprocity for each trade item. A member country that does not include particular products on its IL and does not reduce local import duties can not benefit from the rewards of ASEAN membership.

As detailed above, extra-regional protection and furtherance of the ASEAN automobile industry are to be achieved through a simple tariff-based structure, but the unification of duty levels to 5 percent or under from 2003 is expected to lead to severe intra-regional competition.

2-3-5 Free trade agreements between ASEAN with dialog partners:

In addition, presently ASEAN have signed trade agreements with dialog partners like China, Korea, Japan, Australia, and New Zealand to form free trade areas or closer economic partnership. These free trade areas, in particularly with China, Korea and Japan (in process of negotiation) will lead the more competitive environment for auto industry from Viet Nam and bring up more challengings to auto industry in Viet Nam .

2-4 Problems in traffic rules and the availability of infrastructure

2-4-1 Road and highway

Table 2-7 Extended road, by type of road

Type of road	Total	Component ratio	Paved road	Non paved
National road	15,121	7.2	9,160.2	5,960.62
Provincial road	17,449	8.3	4,638.0	12,811
County road	36,372	17.4	3,611 (9.9%)	32,761
Road in urban	3,211	1.5	3,211	
Sub total	72,153	34.4		
Special road	5,451	2.6		
Village road	46,910	22.4		
Subdivided road	84,545	40.4		
Total	209,059	100.0		

Sources:"Vietnam Moving Forward"World Bank, April 1999; Ministry of Transport, Vietnam Road Administration.

Vietnam's 210,000 km of paved roadway in 1997 provided a paved road ratio of 25 percent[11], very low compared with that of the other ASEAN 4 countries: Indonesia 46 percent, Malaysia 75 percent and Thailand 98 percent. Also many city roads are narrow, which can be considered an obstacle to motorization.

The welfare of the Vietnamese people needs to be enhanced via more roadways suitable for automobile motorization, providing quick transportation and goods distribution. Poor infrastructure for physical distribution not only obstructs automobile market expansion but also fetters industrialization including export and import. Concurrently, measures should

[11] World Bank, World Development Report 1999/2000.

be taken to prevent a rapid increase in traffic accidents. Necessary for this are an automobile inspection system, a licensing system and traffic regulations that meet global standards.

2-4-2 Parking and garage space

With an increase in automobiles comes the need for more parking and garage space, both public and private. At present, parking areas are scarce in Hanoi and Ho Chi Minh City. Infrastructure as well as consideration of transportation policy regarding residential parking is needed in order to handle increases in motorization.

2-4-3 Port/harbor infrastructure

From the viewpoint of industrial development, the preparation of port/harbor infrastructure is essential, particularly for import and export. The government manages eight main ports: Hai Phong, Da Nang, Sai Gon, Quy Nhon, Quang Ninh, Nghe An, Nha Trang and Can Tho. In total goods volume in 1999, Vietnam exported 5,262 thousand tons and imported 6,626 thousand tons. The main export harbor, Sai Gon, accounted for 3,271 thousand tons (62 percent) of Vietnam's total export. Ports and harbors are very important for import-export industries, and in Vietnam the facilities for managing container cargo are lacking.

Hai Phong, Da Nang and Sai Gon are Vietnam's largest ports, but each is built on a riverside and the water depth is not sufficient for anchoring large ships. Increases in import and export require increases in terms of piers, container yards, warehouses, customs clearance systems, etc. Demand for such facilities will increase in line with improved service and heavy equipment.

Chapter 3: Thoughts on Vietnam's future automobile industry policies: Lessons from the experience of ASEAN and other Asian countries

Introduction

Vietnam is not the only country that is obliged to accept trade liberalization. ASEAN countries participating in AFTA, and China and South Korea have also gone through the same ordeal. It is therefore needed for Vietnam to learn from the experience of each of these countries. In order to discuss about Vietnam's automobile industrial policies, it is of great importance to learn from other countries' experiences and how they coped with the problem of developing their automobile industries within the AFTA and WTO frameworks.

This chapter will focus on five countries, namely, Thailand, Malaysia, Indonesia, China, and South Korea, introducing the development process, market trend, and industrial policy in each, followed by the implications for Vietnam's automobile industry.

3-1 Thailand

3-1-1 Development process

Thailand's automobile industry showed signs of development in 1961 when the Royal Government of Thailand established the Motor Industry Company with a view to alleviate the country's complete dependence on assembled imports. In order to promote domestic automobile assembly, the government further induced foreign investments by setting tariff rates for KD and CBU imports at as low as 40 percent and 80 percent respectively. At the same time, the government also stressed its intention to achieve full domestic production of auto parts. To that end, in 1978 it strengthened local content restrictions and banned, with very few exceptions, the import of assembled cars. Those protective policies remained in effect until 1990 (when the government removed some of the restrictions on imports of completely assembled cars) and boosted the domestic production of cars via expansion of the production capacity of the existing assembly plants.

The government consistently maintained that expansion policy until the Asian currency crisis struck the country in 1997, when, in line with the decline of the Thai economy, the domestic automobile manufacturers were confronted by weak car demand. Despite steady recovery in the economy as a whole since then, the domestic automobile market still is smaller than it was in 1996.

Under such circumstances, the Japanese automobile manufacturers in Thailand started channeling their output into exports, cultivating new markets in order to raise the capacity utilization that had temporarily dropped and ride out the crisis. For example, each of them established a production and export base in Thailand for 1-ton pick-up trucks, which account for approximately 60 percent of new automobile production in Thailand. Additionally, they worked to raise the local procurement rates for car parts, which prompted numbers of automobile parts makers to make inroads into the Thai market and extend their operations in the country. As a result, Thailand today is the largest automobile parts production base in Southeast Asia.

3-1-2 Market trend

Sales of new cars in Thailand remained under 100,000 units prior to 1987. But then the new car market expanded rapidly in step with the increases in demand for passenger cars in urban areas and for pick-up trucks in rural areas, all together peaking at 590,000 units in 1996. Sales of new cars, however, tumbled to 140,000 units in 1998 under the effects of

the currency crisis the previous year. Although the new-car market recovered gradually to 300,000 units in 2001, it still remains at 50 percent the level of its peak. In Thailand, there are seventeen automobile assembly makers at present, and the share of Japanese cars is around 90 percent. Looking at the car production trend in Thailand by vehicle types, the share of 1-ton pick-up trucks dominates 55 percent of the domestic market and the greater part of exports.

Most middle class people who were severely hit by the effects of the currency crisis have not yet recovered, which is the main factor for slow growth in demand since 2000. As mentioned above, new car sales peaked in 1996, and it is expected that the Thai upper class's replacement of those cars will peak in 2002, and therewith a large increase in domestic car sales is highly anticipated. Future market trends for new cars, however, depend largely on how well the Thai middle class fares under the coming economic changes.

3-1-3 Industrial policies

The government has adopted a step-by-step removal of restrictions on car trade, and has used upward adjustments on taxes such as VAT, import duty on completely assembled cars, and automobile excises to cope with the production adjustment caused by the currency crisis in 1997. Although Thailand's 1998 attempt to accelerate the abolishment of local content restrictions failed due to protectionist reasoning, in January 2000 the government finally banned them entirely. The government has been striving to free up trade under the terms of CEPT, which requires the reduction of import duties on all ASEAN CBU and CKD cars to 0-5 percent by January 2003. There have been concerns that abiding by the terms of CEPT while simultaneously abolishing local content restrictions might undermine the development of the domestic automobile industry, if the process is implemented too hastily. Therefore, in order to provide some relief to the industry, the government has plans for revising its tax structures within 2002. As seen above, the government has adopted automobile policies that were not centered on the promotion of any specific vehicle type but were rather focused on raising the overall level of the domestic automobile industry, while adopting a step-by-step liberalization of trade.

The Royal Government of Thailand, corresponding to the initiative of Japanese car manufacturers in raising the local procurement rates for car parts in the Thai market, has been earnest in fostering the supporting industries since 1995. In January 2002 the Thai Board of Investment (BOI) started offering incentives for comprehensive investment in car assembly projects, including new parts production projects by car parts suppliers. Additionally, in order to expand the domestic car market, the government also removed the 25 percent advance payment requirement on all car purchases and reduced the VAT rate from 10 percent to 7 percent in 1999.

3-2 Malaysia

3-2-1 Development process

The automobile industry in Malaysia originally started in 1966 when the government set a goal of achieving import-substitute industrialization. The mechanism for this substitution was the allowance of free imports of CKD parts while virtually prohibiting CBU car imports through high duties. However, local production of car parts remained low, accounting for only 8 percent of procurement in 1979. This was because locally produced parts were more expensive than imported parts, which contributed to domestic automobile manufacturers' inability to cut costs. Therefore, as soon as the Mahatir regime came to power in 1981, it took the initiative to develop national-brand cars. Back then the

government was highly convinced that the private sector initiative alone could not achieve the expected success in the development of automobile industry. Proton, Malaysia's first national-brand car company, established in 1983 as a joint venture of the Mitsubishi Motors Corporation, the Mitsubishi Corporation, and the Heavy Industries Corporation of Malaysia, started production in 1985. Supported by the government's wide variety of preferential treatment for national-brand cars, Proton expanded rapidly. The policy enabled Proton to finally achieve a 50 percent share of the domestic automobile market, to the detriment of foreign car manufacturers, primarily Japanese.

The Malaysian government, who was greatly pleased with the steady expansion of Proton, then aimed at the production of cheaper and smaller cars. Perodua, the second national car manufacturer, was therefore established in 1991 as a joint venture with Daihatsu and the Mitsui Corporation, and started its production in 1994. Upon the 1997 establishment of Malaysian Truck & Bus, a joint venture with Isuzu, the number of national car manufacturers grew to three. When the 1997 currency crisis forced these national car manufacturers to reduce their production of cars, the government promptly raised the import tariffs on CBU cars and CKD parts and postponed the planned removal of local content requirements in 1998. Thus, with strong protection of Malaysia's domestic automobile industry being a matter of the government's national policy, the national-brand cars became the driving force behind the motorization in the country. The share of the national car manufacturers in the domestic car production actually reached 82 percent in 2001, which is unequaled in other ASEAN countries.

3-2-2 Market trend

Sales of new cars in Malaysia tumbled to 164,000 units in 1998 as a result of the 1997 currency crisis but swiftly rebounded in the following years. The sales figure in 2001 was 396,000, a year-on-year increase of 15.5 percent, and was close to the all-time high recorded in 1997 (405,000 units). The primary force behind this progressive recovery was the increase in car demand, stirred by the arrival of new Proton and Perodua models in the market and by the government's easing of car loan restrictions. (The maximum loan amount for a passenger car was expanded from 70 percent to 85 percent of the total price, and the term of payment was extended from five years to seven years.)

Malaysia's passenger car manufacturers number eleven: two manufacturers of national-brand cars and nine assembly plants for foreign car models. Viewing the domestic car market by brand, it is clear that national-brand manufacturers hold overwhelming shares, 63 percent by Proton and 25 percent by Perodua. The recovery of Malaysia's car market to the level before the currency crisis, therefore, seems to solely reflect the growth of national car manufacturers. The new car sales of other car manufacturers remain at a mere 50 percent of the 1997 peak level. Thus, it can be said that the strong recovery of sales of national-brand cars was a pure product of the government's preferential treatments such as total and partial exemption of import duties on car parts and excise tax, and easing of car loan requirements.

3-2-3 Industrial policies

It is no doubt to say that the government's efforts to sustain and expand national-brand car production have really defined Malayia's automobile industry. Proton and Perodua have been fostered through the government's protective policies. High import duties, 140-300 percent on passenger cars and 60-200 percent on 4WDs and SUVs, are imposed on completely assembled cars, classified by their displacement. Because these duties on completely assembled cars are so strikingly high as compared to the situations in other ASEAN countries (especially Thailand and Indonesia), it is inevitable that the Malaysian economy will feel the impact of AFTA more profoundly. The government, well aware of

the situation, postponed the planned CEPT application on CBU and CKD cars to January 2005.

As for the government's automobile parts policy, since 1991 local procurement requirements have differed, depending on the size of the end product: 65 percent local procurement for a passenger car of 1,850 cc displacement or less, 45 percent for 1,851~2,850 cc displacement, and procurement of thirty parts or more for a passenger car of more than 2,850 cc displacement. This has promoted local industries by suppressing the imports of car parts, and as a result the domestic car parts makers, especially the *bumiputra* companies, have increased in number. Proton, for example, has expanded the number of its car parts companies from 41 to 188. Being large in number, however, does not itself prove the competitiveness of these car parts manufacturers since the sales of these companies depend solely on national car manufacturers. For this very reason, the government, in order to protect the domestic car parts industry as long as possible, has also postponed (from the originally planned January 2000 to January 2004) the enforcement of the WTO agreement requiring the abolishment of local content requirements.

In this era of trade liberalization, when every US and European car manfacturer is extending its business to ASEAN countires, Malaysia has yet to alter its protection of national-brand cars. Foreign car manufacturers obviously are disappointed that Malaysia postponed its adherance to the terms of AFTA, and any more delay on the Malaysian side is inexcusable in terms of the principle of non-discrimination between domestic and foreign products (GATT Article III). More importantly, one cannot ignore the problem of low international competitiveness of local car parts makers that resulted from the government's protective policies, which is a primary factor in the weak competitiveness of national car manufacturers, rendering them no match for foreign car manufacturers. Although Proton has currently been reconsidering its car parts procurement policy in order to solve the problem, the most important thing here is to ensure the strengthening of the competitiveness of both the national car manufacturers and the national car parts manufaturers before the planned reduction of import duties in 2005.

3-3 Indonesia

3-3-1 Development process

Indonesia's full-scale development of the automobile industry started in the ealy 1970s under the Suharto government when a national car project was launched as a part of import-substitute industrialization. Since the latter half of the 1970s, the government has put emphasis on the production and export of the van-type utility vehicle (basically a small-model commercial vehicle weighing under 5 tons) and its parts. The government, therefore, has implemented a program in which specific car parts, chosen from among the CKD parts that are imported under license, are to be produced locally. The ultimate goal of manufacturing van-type utility vehicles 100 percent locally, however, has not been achieved, due to local companies' immature technology.

In June 1993 right after the agreement on AFTA, the government enacted new automobile policy which reduced import tariff rates in exchange for the raising of local content rates, and thereafter lifted the import ban on CBU cars and abolished policy compelling local production of car parts. Going against the trend of trade liberalization, on February 28, 1996 Indonesia anounced its National Car Program, which was to protect local-brand cars much the same way Malaysia's policy did. This program presupposed a joint venture, one part of which, Kia Motor of Korea, was to receive a wide variety of tax exemptions as a national car manufacturer. Because the scheme violated GATT (Article III regarding

national treatment), Japan, the US and the EU appealed to the GATT/WTO Dispute Settlement Body. The DSB's panel report, adopted in 1998, became the WTO ruling, and the Government of Indonesia, therewith, abolished the National Car Program and began to introduce a policy based on trade liberalization, which is still in effect.

3-3-2 Market trend

Indonesia's sales of new cars, under the effects of the currency crisis and the political unrest later, slumped from its peak of 387,000 units in 1997 to 58,000 units in 1998, and stayed low in 1999 at 94,000 units, before rebounding in 2000 to 301,000 units. The sales were just below 300,000 units in 2001. The sales recovery in 2000 is attributable to the increase in the van-type utility vehicle purchases made by the affluent, who had been refraining from buying cars in the state of confusion after the crisis.

The automobile market in Indonesia is flooded with sixteen assembly makers producing close to thirty models. It is still at an immature stage of development, as is apparent based on the fact that Japanese car companies dominate more than 95 percent of the market, with the van-type utility vehicle accounting for close to 90 percent of new sales. By manufacturer, Toyota has the top market share (25 percent) in Indonesia as a result of its Kijang selling well since being introduced in 1996.

In Indonesia, car marketing has been organized mainly by local distributors, among which are ASTRA International of the ASTRA Group and Indomobil of the SALIM Group. These are the two biggest investment groups in Indonesia and they handle most of the car models out in the market.

Indonesia's distributor-led atomobile development has caused an excess in the number of car models and low capacity utilization by car manufacturers. In the years to come, the relationship between the group companies and local partner companies might be reorganized.

3-3-3 Industrial policies

The Government of Indonesia, after abolishing an incentive tariff system that had allowed reduction of import duties on car parts in proportion to percentage increases in local procurement rates, adopted new car policy in 1999 that completely liberalized imports of CBUs and car parts. The precepts of this policy are (1) abolishment of preferential treatment for the use of locally produced parts, (2) reduction of the import duties on CBUs and liberalization of CBU import, and (3) differentiation of CBU, CKD and IKD parts tariff rates from other minor parts imported for local assembly. The third of the three precepts is the only protection extended to the local car industry. For example, for a 1,500 cc displacement passenger car with 20 percent or less local content, import duties on CKD parts are reduced from 65 percent to 35 percent, and excise tax is reduced from 35 percent to 30 percent, which enable price cuts. Additionally, Indonesia went ahead of Thailand in accelerating the implementation of the CEPT schedule, and reduced intra-ASEAN import duties on CBUs and CKD parts to 0-5 percent (beginning in January 2002).

This tells us that Indonesia has quickly been pushing ahead with trade liberalization without giving much thought to the current state of the country's industry. The car policy introduced in 1999, for instance, snatched away the benefit (the preferential treatment that allowed complete or partial exemption of import duties on car parts) given to all the existing car companies in exchange for their meeting certain levels of local content requirements. The new policy may prevent foreign companies from benefiting from their previous heavy investment to meet the government's local content requirement.

Indonesia acceded to trade liberalization on condition that it would receive overseas aid during the crisis, but it does not have a clear plan for developing the automobile industry after the actual removal of the restrictions on trade. For this reason, all the interested parties representing the local automobile industry have been (1) requesting that the government clarify its automobile policy and execute it without failing and (2) expressing a need for protecting the local automobile industry from free trade with extra-ASEAN countries.

3-4 China

3-4-1 Development process

Development of the automobile industry in China started when a state-owned car assembly plant was established in 1956 with assistance from the former Soviet Union. Later, after the establishment of the China Automotive Industry Corporation in 1964, the government aimed for unified development of the automobile industry by introducing a division of labor among the regions. Then according to its 5th Five-Year Plan (1976-80), the government adopted a policy of opening up to the outside world, as a result of which most of the regional car plants came to agree to technical tie-ups with foreign car manufacturers. However, in the 6th Five-Year Plan, automobile industry was removed from the list of priority industries and floundered. Not until the government designated it as a foundation for China's industrialization (7th Five-Year Plan) did the automobile industry endeavor to introduce foreign investment.

In 1994 the government announced the Automotive Industrial Policy, in which it aimed to build a 5,000,000 unit production system by 2000. Regarding passenger cars as luxury items, the government had long been discouraging such purchases, while praising trucks for their value as capital goods. With the adoption of the 1994 Automotive Industrial Policy, however, the government came to admit the necessity of popularizing passenger cars in order to foster automobile industry as a foundation for China's industrialization. With this policy, the government has indeed accelerated the inflow of foreign car manufacturers and car parts makers from Japan, the US, and the EU into the domestic automobile market. Volkswagen (VW), Chrysler, and PSA were among the first to make inroads in the market in the 1980s, followed by Japanese car companies, GM, and Ford in the 1990s, all of which have contributed to the establishment of the car production system in China through the expansion of their production bases.

During the period of transition from planned economy to market economy in the 1990s, however, there were disparities between the planned output and the actual demand, due to a slack market under the effecrt of three major reforms—namely, the financial reform, state-owned enterprise reform, and administrative reform. The government, for instance, could only meet half of its goal of manufacturing 1,200,000 cars, and thus development of the automobile industry appeared to have stagnated. Demand insuffiient in the market can be explained by two main factors: (1) local governments used to collect all sorts of expenses other than taxes when people made purchases; and (2) the parking fees in urban areas are high due to limited parking space. China, outgrowing the former socialist policy, has finally reached a new stage of development within a capitalist framework, the progress of which has been facilitated by China's entry into the WTO in 2002 and the formation of the 10th Five-Year Plan (begun in 2001) grounded on China's recent experience.

3-4-2 Market trend

Sales of new cars in China has doubled within the past ten years, from 1,180,000 units (including 210,000 imported cars) in 1992 to 2,430,000 units (including 70,000 imported

cars) in 2001. China's automobile market, in terms of its size, ranks seventh in the world and second in Asia after Japan's. As for the structure of the market, the passenger car segment has been constantly expanding its share of new car demand after having been slow in gaining popularity—long trailing the bus and truck segments. Looking into sales of new automobiles, the percentage shares of passenger cars, trucks, and buses have changed significantly between 1992 (16%, 59%, 24% respectively) and 2001 (30%, 35%, 35% respectively), showing equal rivalry among the three in 2001 compared to trucks being the sole winner in 1992.

Sales of passenger cars in China, when imported and locally produced ones are added together, have almost quadrupled during the past ten years, from 200,000 units in 1992 to 770,000 units in 2001. Looking at brand share, VW, which was first to enter the market and currently has two production bases there, continues to hold the largest (42 percent). And the top five car manufacturers—namely, VW, Tianjin Automotive Industry Corporation (TAIC)[12], GM, PSA, and Honda, together dominate the market (72 percent). As for the sales of trucks and buses, trucks increased by 42 percent (from 580,000 units to 820,000 units) and busses more than tripled (from 240,000 units to 820,000 units) between 1992 and 2001. The predominant share of the market for trucks and buses, with the exception of small-sized ones, is held by the top few local-brand manufacturers.

China, as of 2000, has 118 car manufacturers. This includes First Auto Works (FAW) and Dongfeng Auto Works (DAW), both of which are owned by the central government and have full production lines for both passenger and commercial vehicles; Shanghai Auto Works (SAW), which is owned by local government and is good at bus production; and Tianjin Auto Works, which specializes in small passenger car production. Since the beginning of 2000, China's new-rising corporate groups have been actively entering the passenger car market, now opting less for joint ventures with foreign companies than in the past. Since half of these local manufacturers are small-sized and produce no more than 1,000 units a year, the government has been restructuring the automobile industry.

China's automobile market is expected to grow, reaching 2,800,000 units in 2002 and exceeding 3,200,000 units in 2005, due to the increasing number of the wealthy class in major urban areas on the coast. Furthermore, the 2008 Olympics may have a role in increasing motorization in China. There are some who even predict (JAMA) that by 2015 China will become the second largest automobile market in the world, exceeding Japan's market size.

3-4-3 Industrial policies

In June 2001 the government announced the 10th Five-Year Plan, which is to be completed by 2005. The Plan has two major changes from the previous one, regarding the automobile industry. First, the government's policy changed from promoting a centrally-controlled production-led system to a market-based demand-led system in which the government first investigates the actual conditions of the market demand and therewith takes necessary steps to foster the consumer market and adjust production through indirect policy measures. Second, taking advantage of its entry into the WTO, the government now stresses the importance of increasing the automobile industry's competitiveness by the regrouping and consolidation of the existing manufacturers through market competition. It has set a target of producing a total of 3,200,000 units (including 1,100,000 passenger cars, 950,000 trucks, and 1,050,000 busses) by 2005. The target number has been calculated based on the annual average production increase of 9.4 percent between the years 1998 and 2000, thus reflecting the actual condition of demand, which is a big step forward compared to the

[12] TAIC is a local manufacturer that cooperates with Toyota and Daihatsu.

previous Five Year Plan. And in order to meet that target, the Plan aims to regroup and consolidate the existing local manufacturers into a group of large-scale enterprises, which consist of two or three car assembly makers and five to ten car parts makers. Even more specifically, the Plan intends to establish a unified car production system composed of three major internationally competitive enterprise groups, namely an FAW Group, an SAW Group, and a DAW Group. The Plan also aims to raise the total domestic share of the three groups from the current 43 percent (FAW's 17%, SAW's 14%, and DAW's 12%) to more than 70 percent by 2005.

Formally approved as a member of the WTO in December 2001, China has agreed to the following adjustments concerning the automobile industry:

1. Gradual reduction of the current import duties on completely assembled cars (from 40-45% to 25%) and car parts (from 46% to 10%) by 2006
2. Complete abolishment of the import quota system and import licensing system by 2005
3. Abolishment of local content requirement and currency exchange regulations
4. Relaxation of the restrictions on foreign investments by allowing foreign entities to participate in sales, maintenance services, distribution, and the provision of car loans and insurance

Since its entry into the WTO, China has shown new changes in its automobile policy, the details of which are presented below.

1) Trade liberalization policy

The import of completely assembled cars is expected to increase due to the gradual reduction of import duties, beginning in January 2002. Additionally, manufacturers will become able to cut costs by procuring parts internationally at the international market rate, due to the lower tariff rates under trade liberalization. At the same time, it is inevitable that any car manufacturer or car parts maker without a firm financial basis will go out of business, partly due to price reductions based on a drop in the retail price of imported cars by 10-20 percent, and partly due to a switchover to imported car parts from inferior locally produced car parts. This is the very reason that the Government of China insists on the necessity to consolidate the automobile industry into three major groups, as described earlier. In the years ahead, however, the automobile industry might fragment contrary to the government's intention. This is because the abolishment of the government's protective measures, which began after its entry into the WTO, will most likely bring about a flood of new foreign investments and vitalize new corporate groups in the provinces.

2) Demand expansion policy

In conjunction with a fall in the price of passenger cars after China's entry into the WTO, the government has adopted many policies to encourage car purchases. For instance, the prices for car related services were revised, car loans were made available, and parking lots were constructed. Since the participation of foreign investors in sales, maintenance services, and financial business will increase in the years to come, the establishment of sales networks in China by the world's leading automobile manufacturers will be essential for expanding the consumption.

3-5 South Korea

3-5-1 Development process

South Korea's automobile industry originated in 1962 when the first domestic car assembly company was established according to the Automobile Industry Protection Law, which was enacted as a part of the 1st Five-Year Plan for Economic Development. From

then until the early 1970s, South Korea's policy for automobile industry development centered around promoting CKD production and substituting locally produced CKD parts (produced by specific car manufacturers selected by the government) for imports. The Government of South Korea, in 1974, drew up the Long-Term Plan for the Development of Automobile Industry, in which the automobile industry was regarded as one of the most strategically important national industries. Following the Plan, South Korea developed a unique model and successfully hit a one-million-unit production target by 1981 and a two-million-unit target by 1986. Conditions in the automobile industry became critical when car parts makers went bankrupt one after another as a result of a sudden drop in demand after the second oil crisis. However, motorization was accelerated by the 1988 Seoul Olympics, and South Korea finally reached the mass production stage. This is also the time when three major *chaebol* (conglomerates), namely, Hyundai Motor Company, Daewoo Motor Co., Ltd., and Kia Motors Corporation, established a dominant production system.

During the 1990s, a time of free competition (completely liberalized car imports and removal of all restrictions on car models), South Korea's automobile industry became even more predominantly based on *chaebol*-led production of local-brand cars. However, it had to confront drastic structural reforms under the guidance of the IMF in the aftermath of the 1997 economic crisis. Since 1998, five *chaebol* and nine *chaebol*-affiliated companies have been consolidated into four *chaebol* and five *chaebol*-affiliated companies. Hyundai Motor Company, which holds 76 percent of the domestic automobile market and is a shareholder of Kia Motors Corporation (holding a little over 30 percent), decided to break away from the Hyundai *chaebol* structure and form its own Hyundai Motors Group. Meanwhile, GM of the US stepped in to purchase Daewoo Motor, France's Renault purchased Samsung Motor, and Daimler-Chrysler implemented a capital tie-up with Hyundai Motor. Afterwards, virtually none of South Korea's manufacturers were 100 percent native capital owned. In the past, the industry had prospered with the steady growth of CBU exports, taking advantage of low domestic labor costs and a growing domestic market that was closed and teeming with patriotic sentiment. Now, growth is being strained by drastic reorganization of the industrial sructure. Entering the twenty-first century, South Korea's automobile industry is in an age of finding its competitive position in the world market.

3-5-2 Market trend

Sales of cars in South Korea reached 1,640,000 units in 1996, fell sharply to 78,000 units in 1998 in the aftermath of 1997 economic crisis, and then rebounded in the following year. In 2001, car sales reached just over 1,450,000 units, which was below the peak in 1996.The automobile industry recovery can be attributed to the government's low-interest policy, which reduced consumers' car loan payments, and to the reduction of special excise taxes. The increase in demand has had to be supported entirely by the middle class's need to replace middle-to-large-sized cars, because high unemployment has dampened young people's demand for small-sized cars. As for brand share in the passenger car market in 2001, Hyundai-Kia maintained its stable hold on the largest share at 70 percent; followed by Daewoo Motor, the third largest assembly maker in South Korea, at 18 percent (fluctuating violently between 10 percent and 20 percent); and Renault-Samsung, which expanded its share year on year, from 5 percent to 11 percent.

Production of cars in South Korea, on the other hand, dropped to 1,950,000 units in 1998, before an export-led rebound in 1999 to 2,840,000 units (the level same as 1997). Car production in 2000 reached a new peak, 3,110,000 units, which included 1,680,000 units for export. Exports, mostly of new model passenger cars (74%) and multipurpose vehicles (17%) to North America, expanded by 11 percent year on year and accounted for 54 percent of the entire production. The automobile market is expected to establish a new high

in 2002 at a total of 3,150,000 units (1,680,000 units for domestic demand and 1,630,000 units for export). The FIFA World Cup is expected to have increased domestic demand by 5.2 percent. Special excise taxes had a positive effect on sales increase in 2001. Because these taxes will be abolished in 2002, true recovery and expansion of the domestic market will not occur without a rebound in sales of small-sized cars to the young. Meanwhile, an 8.6 percent year-on-year increase in exports is expected due to an increase in the number of KD sets exported to the overseas production bases of the Hyundai Motor Group.

3-5-3 Industrial policies

Since the economic crisis, South Korea's automobile industry policies have focused on the strengthening of international competitiveness, centering mainly around the promotion of the automobile parts industry. The Government of South Korea, in July 2001, announced its Basic Plan for the Development of Car Parts and Base Material Industries in which the governement invests 2 trillion won to bring 150 manufacturers of parts and materials up to international standards. South Korea came to regard the development of parts and materials industries as vital, after having suffered from overemphasis on the development of car manufacturers. Since car manufacturers in South Korea were *chaebol*-affiliated, so too were their car parts makers, and this made standardization and technology sharing and accumulation difficult in the industry. South Korea's car parts industry has been slow to become profitable and to develop original technology and thus is still outdone by the competitiveness of its international rivals.

Since the economic crisis, increases in foreign investment in South Korea's automobile industry have come in rapid succession. As a result, the total amount of foreign investment directed to the 182 automobile parts makers amounted to US$2.1 billion as of 2001. About half of the auto parts makers that have made inroads in South Korea are from Japan, followed by those of the US and Germany. Through tie-ups with foreign couterparts, South Korea is planning to strengthen the development of safe, environmentally fit, low energy–consuming technology in its system for global supply and parts procurement. The government supports development of the parts industry by adopting market measures such as a sliding scale (in proportion to the size of displacement) for taxes on car purchase, registration, and possession. As well, the government intends to provide minivans that consume less fuel and further reduce highway tolls and automobile tax. Again, the intent of all these measures is to nurture South Korea's car parts industry.

3-6 Lessons to be learned from the five countries:

3-6-1 Thailand

Thailand, although having no national-brand car of its own, is establishing itself as the largest automobile manufacturing base in Southeast Asia. This is the fruit of the government's steady efforts in fostering supporting industries through step-by-step trade liberalization policy. In order to attract automobile industry, including supporting industry, the Thai government strengthened its investment incentive measures, export incentive measures and measures to supply human resources. Also it formulated a consistent tax structure, setting detailed tax rates for each part. These measures are good practices that Vietnam should learn from.

Because of this government policy, a large number of car parts makers were especially successful in making inroads into Thailand. One must take into consideration the fact that Thailand had a fair amount of leadtime in which it made steady efforts in establishing supporting industry. For example, the Board of Investment has long provided strong incentive for foreign car parts makers to invest in Thailand's Export Promotion Zone.

3-6-2 Malaysia

It may safely be said that Malaysia's automobile industry policies exist for the sake of Proton. The government provided the company economic favors in exchange for involvement in the management of Proton, wherein employment was guaranteed and *bumiputra* companies were promoted. In this way, the Malaysian national car project contributed to the development of the national economy and to securing employment. Furthermore, Malaysia became the largest automobile market among ASEAN countries because of its increase in national income increase, its improvement in infrastructure and its political stability as well as the selling of appropriate models at affordable prices. These aspects would be useful lessons for Vietnam.

Malaysia has postponed from 2003 to 2005 its adherence to AFTA's CEPT rules on reduced import duties on automobiles. Despite such postponement, government-led automobile industrial protection is bound to end, because protection weakens the international competitiveness of national car manufacturers and external pressure for opening up the domestic market is becoming stronger. If Vietnam decides to protect a Vietnamese car manufacturer, it will likely suffer similar weakness and very high costy. Therefore, given the AFTA and WTO frameworks, a launching of a Vietnamese national car project is far from appropriate taking into consideration the current situation of the automobile industry, the size of the market, and the large number of existing car manufacturers.

3-6-3 Indonesia

In the post–Asian economic crisis, Indonesia has given up its national car project and overhauled its atuomotive industry policy, changing from protectionism to liberalism after its accession to the WTO. In line with this, Indonesia has pushed forward its timetable for realizing AFTA precepts through the reduction of import duties. The liberalization implies a cancelation of the advantages that foreign companies had been granted for early investment that raised local content rates. However, Indonesia has introduced a gradual tariff rate system as its prime automobile policy, which is an appropriate means to strengthen the supporting industry. At present, the government imposes higher tax on CBU than on parts, and higher tax on parts than on materials, in order to equip the auto parts industry with international competitiveness against the coming trade liberalization. This strategic tax policy has implications for Vietnam's automobile industry. In addition, from the experience of Indonesia, it should be recognized that political uncertainty would discourage foreign direct investment.

3-6-4 China

Vietnam's automobile industry development has proceeded differently than China's, but they are similar in the fact that both aim to realize a "socialist market economy". China, having begun its 10th Five-Year Plan (in 2001) and having secured WTO membership (in 2002), has begun changing the priority of its industrial policy—from production-oriented policy to market-expansion policy. The government has, at the same time, worked out policy aimed at stimulating the purchase of passenger cars. This, in particular, is a good guide for Vietnam, whose passenger car demand is expected to increase in the future.

China still has to cope with the problems of consolidation, privatization, and abolishment of non-competitive state-owned automobile and automobile parts makers, problems that are inevitable when liberalization policy is put into effect. In Vietnam, the same scenario is expected when it joins AFTA and the WTO, because of the large number of state-owned enterprises. The Government of China has already concluded, based on analysis on the impact of its entry into the WTO, that a certain level of sacrifice is unavoidable, and that

non-competitive enterprises will be left to fend for themselves. Learning from China's experience, the Vietnamese government must closely examine how it can promote its infant automobile industry prior to joining the WTO, because few measures are available after joining.

3-6-5 South Korea

South Korea took various measures to foster a national automobile industry early in the course of the country's industrial development. But since the Asian economic crisis, it has gone through drastic structural reform and implemented the Basic Plan for the Development of Car Parts and Base Material Industries of 2001. Because a weak automobile parts industry has hindered the development of the automobile industry as a whole, the government is now focusing on how to develop the country's technology level in automobile parts in order to increase its international competitiveness.

At present, the most important thing for the Vietnamese automobile industry is to actively invite foreign capital auto parts industry and to promote accumulation of supporting industry. In this sense, the strategy for the Korean auto parts industry after the Asian economic crisis—that is, strengthening local auto parts makers through FDI—is the most appropriate lesson for Vietnam.

Chapter 4: The Orientation of Automobile Industrial Development and Policy in Vietnam

4-1 General statement

4-1-1 Purpose and direction of industrial development

4-1-1-1 The purpose of industrial policy

The automobile industry is recognized by the Vietnamese government to be one of the key industries for Vietnam's socioeconomic development. However, time and options for developing particular industries are gradually dwindling as Vietnam's regional and global commitments grow in line with its integration into the world economy, specifically in the contex of joining WTO. It is essential, under these circumstances, that policy on the automobile industry aim at development in an effective and efficient manner and at production that both satisfies national demand and benefits the nation as a whole.

4-1-1-2 Direction

Certainly global economic circumstances are gradually making it difficult for a latecomer country to adopt protective policy for a particular industry. Facing this reality, Vietnam needs to decide how to make a commitment, in order to develop her automobile industry or to give it up. It would not be an easy task for Vietnam to implement a protective automobile development policy while addressing her regional and international obligations. The Vietnamese government, however, recognizes that automobile industry is essential to the country and is determined to take an "active and decisive" role in its development.[13] To do so, the government needs to adopt a new policy, a "Vietnam model," and implement it at low cost. In the "Vietnam model," FDI is invited in a short period and concentrations of supporting industry in specific fields will be promoted. This new policy must also include both the socioeconomic effectiveness viewpoint and the national economy defense viewpoint—that is, it must be important both for secure employment and increasing salaries and wages, and for economic defense in the case of sanctions imposed by other countries.

In order to develop automobile industry in Vietnam, it is necessary to make effective use of the existing joint venture assembly industries on the one hand and to foster supporting industry on the other hand. It is unreasonable to produce vehicles on a "full-set" (including all parts and materials) basis, in Vietnam. Rather, under the current trend of economic integration and the limited time available, it is more practical for Vietnam to develop its automobile industry strategically, making efficient use of foreign direct investment. While taking measures to foster the existing assembly makers, it is important to broaden the supporting industry base and promote the transfer of technology through inviting parts makers, which would be followed by investments by second- and third-tier suppliers. At the moment, it seems difficult for local supporting industries to become suppliers of sophisticated automobile parts in a short period of time. Thus, by inviting foreign suppliers and encouraging accumulation of supporting industries in specific fields, sophisticated technology and know-how will be disseminated to local suppliers and the base of the domestic supporting industry will be gradually broadened and strengthened. Concurrently it is essential that local suppliers learn how to produce high quality products that will satisfy foreign manufacturers. In order to achieve this goal, the government needs to

[13] Ministry of Industry and Institute for Industry Policy and Strategy, "Orientation of Vietnamese Automotive Industry", April 23, 2002.

implement measures to attract direct investment by foreign suppliers and to make them continue their operation within the country, as well as measures to encourage technology transfer from foreign to domestic suppliers. In order to do so, the government needs to commit itself to implementing a coherent policy under the stable political environment.

Efficient and effective use of foreign direct investment, too, is critical to the ability of Vietnam's automobile industry to attain unique competitiveness in the international market. International competitiveness means to be competitive in quality, cost, price, advanced technology (environment, safety and IT) and ability to ensure a stable supply of products. In order to achieve such competitiveness, strengthening supporting industry and expanding domestic and export markets are crucial. As such, FDI incentives should be used. There, however is a need to rationalize them. Incentives should be evaluated on their economic merit, and based on clear and transparent criteria.

Although most countries apply investment incentives nowasday, the usefulness of investment incentives should be questioned. Overuse of investment incentives risks eroding the tax base for little gain and placing the tax burden on other taxpayers. It may be better to encourage investment is to liberalize the investment regime so that all investors, foreign and domestic, do not face barriers or unnecessary hurdles. Removing such impediments and promoting investment through facilitation activities, such as a one-stop promotion agency some time is better than offering incentives. The regime should not treated foreign investors more favourably than domestic ones. Investment is of similar economic value whether sourced domestically or from abroad. Investment impediments should be identified and reformed unless there are convincing economic reasons for maintaining them.

Investment incentives may be ineffective in attracting investment. It, however can be counterproductive. Investment incentives are seldom among the main determinants of business decisions. Proximity to markets, the availability of sufficient skilled labour at relatively low cost, adequacy of essential infrastructure, and a stable economic, legal and political environment are usually much more important. The cost of such measures in revenue foregone can exceed the amount of incremental investment generated. Identifying such incremental investment and the revenue foregone by investment incentives is an essential starting point in evaluating the economic merits of such subsidies.

Use of investment incentives may also provoke countermeasures by trading partners. Countries may react by adopting incentives of their own, and such an "incentives race" or "shopping" harms all countries, especially developing countries.

In the course of time, measures to expand the opportunities for exporting automobile parts to other ASEAN countries, utilizing the AICO and CEPT schemes, will be necessary. By doing so, Vietnam will have the opportunity to participate in ASEAN's automobile parts complementation system: producing auto parts that are currently being procured outside of ASEAN. Utilization of foreign direct investment for domestic production of such parts would be essential for the strategic development of supporting industry within Vietnam. Simultaneously as efforts are being made to develop export opportunities, the domestic market needs to be expanded. To do so requires the creation of an environment that will encourage automobile purchases; useful measures include development of financial services for consumers such as automobile financing and leasing and infrastructure improvement (parking space, roads, etc.).

4-1-2 Production of automobiles

4-1-2-1 Production by joint venture car manufacturers

Vietnam's policy on automobile industry development at present needs to strengthen production by utilizing both joint venture automobile manufacturers and domestic auto-makers to establish a production system that focuses on attaining import substitution. Currently there are eleven automobile assembly companies in Vietnam, and they are operating at low production rates due to Vietnam's small domestic market. By introducing preferential measures for the automobile industry and developing its supporting industry, the total production volume will increase and, accordingly, the unit price will decrease. The assembly makers will gradually gain competitiveness in producing high-quality products at reasonable prices, and the number of manufacturers will be naturally selected by the market.

4-1-2-2 Production of "non-luxury cars"

Non-luxury means cheap cars, which can be afforded to people with lower income. To produce non-luxury as well as high quality cars, the government should take measures to promote market segmentation between the two and provide a level playing field in the market. In order to develop an automobile industry that would be sustainable even after regional and global economic integration, discriminatory measures and policies favoring non-luxury vehicles should not be adopted.

Many problems must be solved before a national car can be developed, which entails full-set production by local companies, and such endeavors have not been successful in other countries. Low-priced products made under a heavily protected environment might sell temporarily, but in many such cases, the low prices are accompanied by low quality. The policy, therefore should be formulated on how for industry to sell the products in the less protected environment. Information technology, environment technology and safe-product technology are some of the main keys to international competitiveness in the automobile industry, and these are difficult to develop. Also, under the current trend of global economic integration, it is difficult, and against economic rationalism to adopt protective policy aiming at increasing national car sales, such as is being implemented by the Malaysian government.

4-1-3 Preparation in the domestic market

In order to develop automobile industry, measures to broaden and expand domestic demand for automobiles are required. Infrastructure development is needed, but so too are measures to improve the systems for automobile financing and leasing. At present, these tools are too immature to stimulate either automobile demand or a broadening of the market. For automobile demand to expand in line with income growth, these systems will have to be developed and improved.

Currently automobile financing is not so popular in Vietnam; it is said that about twenty percent of automobile purchases in Ho Chi Minh City are financed through a bank, and the estimated comparable figure in Hanoi is about five to ten percent. The cash on delivery (COD) payment method is preferred, as ownership is very important to the Vietnamese people and in the automobile financing scheme, the automobile title is not transferred until the completion of the payment. Besides such mentality on the user side, it appears that improvement in loan application procedures is necessary; the current procedure has complications such as a requirement for monthly certification of ability to pay. Improvement can also be obtained by developing a system for automobile purchasing through leasing. Leasing companies are said to focus on corporate customers, mainly for the leasing of equipment and appliances. It seems that without a strong legal environment,

neither the automobile manufacturers nor the leasing companies are willing to take on the customer risk for leasing to individuals. It is essential that Vietnam establish a legal framework that reasonably reduces risks in installment payment and leasing and improves the application procedures for automobile financing.

4-1-4 Preparation for infrastructure

Also important for development of automobile industry and growth in automobile usage is improvement in infrastructure. On the consumer side, upgrading the road network and increasing the availability of parking spaces would enhance the convenience of automobiles and contribute to an increase in automobile demand. On the industry side, improvement in road network and in port infrastructure would lead to reduction in transportation costs, which would benefit not only the automobile industry but also the economy as a whole.

4-1-4-1 Road and highway

Upgrading of the road network is vital for automobile industry development, but additionally it contributes to socioeconomic development. As of 1999, the pavement ratios for national roads and regional roads were about 60 percent and 30 percent respectively, but in order to popularize automobiles and prepare for motorization in urban areas, it is indispensable that urban area roads be improved. At the same time, improvement (and maintenance) of the major roads that service commercial ports and Vietnam's border areas with Cambodia, Laos and China is important from the perspective of physical distribution. Such improvement reduces distribution costs and, accordingly, facilitates domestic and international physical distribution and stimulates economic activities. The Ministry of Transportation is planning to spend VND 31 trillion nationwide in 2005 to expand the road network—extending it to remote villages and connecting/maintaining routes between material production sites and manufacturing sites and markets.[14] Concurrently, measures need to be taken for road network improvement in urban areas.

4-1-4-2 Parking and garages

The scarcity of parking space is often mentioned as one of the obstacles to an increase in automobile sales. Current housing conditions in urban areas make it difficult to find parking space for automobiles; to accommodate parking, the first floors of houses have to be converted or lots or garages have to be rented. In preparation for the inevitable future motorization of urban areas, it is necessary to prioritize measures to increase the availability of parking space, such as measures to promote investment in constructing parking spaces.

4-1-4-3 Port/harbor infrastructure

Also important for automobile industry development is improved port/harbor infrastructure, because it will lead to reduction in transportation cost for importing and exporting, which is one of the factors that attracts foreign investment. A particular area to be addressed is the shortage of deep-water ports, which are needed for competitiveness vis-à-vis neighboring countries. This is addressed in the Vietnam Port Authority's 10-year port investment development plan, which categorizes all ports into eight groups and aims at upgrading port facilities.[15] The New Saigon Port has become a modern container port. It has a 700-meter

[14] Vietnam Keizai Kenkyuujo, "Vietnam Keizai Doko" No. 235, June 30, 2002.
[15] Vietnam Keizai Kenkyuujo, "Vietnam Keizai Doko" No. 233, May 30, 2002.

pier along which a 10,000-ton ship can dock, and a container yard and warehouses will be built in 2004.

4-1-4-4 Registration system for vehicles

Currently automobile registration is done in two steps: one, the Ministry of Transportation checks and controls the quality and safety of automobiles, and two, the traffic police department of the Ministry of Public Security issues the licenses. Registration can be done at each province. Along with the development of automobile industry and the growth in automobile volume, it would be necessary to improve and strengthen the automobile registration system, in order to implement appropriate quality and safety control for the increasing number of vehicles and to manage nationwide information and data of automobile registration. Accordingly, old vehicles need to be checked and should be disposed of if there is any problem in safety.

Box 4-1: Preparation for a Motorized Society

Along with increase in the number of automobiles in the city and in the level of motorization, it is essential to prepare an environment and a system that are suitable for a motorized society. Summarized below are some measures that Vietnam might take for her preparation to be a motorized society.

- It is necessary to introduce an integrated management system for urban transport in Vietnam, improving planning, management, implementation and control of the urban transport system. In particular, with the increase in the number of four-wheeled vehicles intermixing with the huge number of motorbikes in the traffic flows, such issues could be addressed immediately as the needs to improve the traffic road design at intersections and to control the sidewalk activities that run off the edge.
- To improve the traffic environment, 4Es—engineering, education, enforcement and environment protection—need to be implemented. Improvement in traffic rules and regulations and their enforcement will lead to better traffic engineering, better traffic safety and better protection of the surrounding environment.
- For better traffic management and control, analysis of the relationship that driving behavior has on congestion and accidents is needed in each category of transport, such as two-wheeled (i.e., motorbikes) and four-wheeled vehicles. Measures should be taken to prevent accidents by keeping major through-town and cross-town traffic flows away from key commercial areas, especially flows with heavy trucks driving at high speed. An increase in urban area parking space to accommodate growth in the number of four-wheeled vehicles is also important.
- Improvement in the behavior and skills of drivers and other road users is essential to reduce traffic accidents. Safety campaigns on the wearing of helmets and on the daytime use of running-lights are examples of effective policy, as is skill training for motorcycle riders and truck drivers. Also, for the benefit of children, traffic safety could be introduced into school curriculums.

(Summary of "Urban Transportation Problems in Vietnam and the role of VAMA" by Mr. Minoru Kobayashi, presented at the Vietnam Motor Show Seminar held in Hanoi, Vietnam in June 2002)

4-2 CONCLUSION OF POLICY RECOMMENDATION

4-2-1 Preferential measures for FDI

In the short term, making the best use of existing foreign capital makers and newly investing companies should be given first priority. Attracting new FDI and promoting the current manufacturers are equally important, and together complementary for the fostering of automobile and other high technology industry.

4-2-1-1 For currently existing players

Preferential treatment should be given to activities that promote the industrial development of Vietnam activities such as reinvesting, improving local procurement, providing technical assistance to local companies, and allying with groups. Preferential measures for

existing company groups and alliances that make further investment in (expansion into) Vietnam are expected.

The automobile industry is stratified into car manufacturers, first-tier parts groups, second-tier parts groups, and so on. Any investment by any of them affects all of them, because it affects the production relationship as a whole. The total investment volume of existing company groups and alliances should be taken into account when considering preferential measures such as tax reduction and extra depreciation for promoting the domestic car production industry. Company profits that are ploughed back into the capital should also be treated favorably: reduction of taxes and extension of the tax release term.

4-2-1-2 For newly investing companies

The importance of FDI, especially FDI in supporting industry, is a recurring theme. To compete with other ASEAN countries for FDI, Vietnam should provide very attractive incentives that can be enjoyed over the long term and should show that the approval procedure is completed in a short period of time. Vietnam's measures to attract FDI are similar to those of other ASEAN countries, but electricity and international phone call services are more expensive in Vietnam than in other countries even after the recent reduction in communications prices. Infrastructure is an important element in investors' decisions on investment; so, to compensate, Vietnam needs to introduce FDI policy that is more attractive than that of other countries.

The Vietnam-US BTA abolishes the double standard on price, which is welcomed and will lead to increased FDI from the US. The most effective form of investment incentive is corporate tax breaks. Cost reduction for construction and maintenance of infrastructure such as roads, electricity and communications are also important elements to attract FDI. Vietnam must make its tax levels and cost level more favorable than those of other ASEAN nations if it wants to become an attractive investment prospect (table 4-3 as reference).

Potential foreign investors expect attractive incentives such as lower tariff rates on intermediary inputs for export products, incentives for exports, and low interest lending policy by banks.

A good reputation among the companies that have already invested in Vietnam is another important element. If early investors are happy and well taken care of by the Vietnamese government (various types of support), then additional investment will be attracted.

The role of governmental institutions that support FDI, such as the BOI in under MPI in Viet Nam has a role that is increasing in importance as Vietnam competes with ASEAN member countries as well as China for FDI.

Table 4-3 A comparison of investment conditions in ASEAN nations

			Thailand (Bangkok)	Malaysia (Kuala Lumpur)	Indonesia (Jakarta)	The Philippines (Manila)	Vietnam (Hanoi)
Land prices	Purchase price of industrial land	$/㎡	44.99[1]	49-99[2]	45-60[3]	60-70[4]	2.6/year[5]
Com-muni-cations	Phone connection fee	$	65.67	165.26	32.96	67.25	93.07
	Basic monthly telephone fee	$/month	2.25	9.21	3.08	25.54	1.79
	International phone calls (3 mins to Japan)	$	2.29	2.60	1.92	1.20	6.93
Utility costs	Corporate power costs	$/kWh	0.037-0.039	0.05	0.03	4.23[6] 0.036-0.038	0.07
	Corporate water costs	$/㎥	2.02[7] 0.21–0.36[8]	0.47 (~35m^3) 0.51 (36m^3~)	0.49	0.17 (~1,000m^3) 0.21 (1,000m^3~)	0.23
Wage levels	Minimum legal wage	$/month	3.71/day[9]	none	55.67[10]	4.55/day[11]	41.61[12]
	Worker (general technician)	$/month	141	198[13]	67	92–146	75–115
	Engineer (middle-level technician)	$/month	302	712	138	173–384	189–313
	Middle-level manager (department or section head)	$/month	622	1,510	337	350–793	472–541
Transpor-tation	Container transport (40' container: factory → nearest port → Port of Yokohama)	$	1,451[14]	697[15]	675[16]	1,084[17]	1,500[18]
Tax	Corporate tax (basic tax rate)	%	30	28	10–30	32	10-20, 25[19]

Source: "*Dai-11-kai Ajia syuyou-toshi/chiiki no toushi-kanren kosuto hikaku*" (The 11th Cost Comparison of Investment Conditions in Key Asian Centers), in JETRO Sensor Vol.52 No. 617 April 2002, JETRO.

[1] Amata Nakorn Industrial Estate.
[2] Selangor Science Park.
[3] Kota Bukit Indah Industrial Park.
[4] Privately developed PEZA zone.
[5] The annual lease per m^2 in the Saidong industrial estate.
[6] Basic fee.
[7] Basic monthly fee.
[8] Additional fee charged if over 10 ㎥.
[9] Last date of revision: January 1, 2001.
[10] Last date of revision: January 2002.
[11] Last date of revision: February 15, 2002 (Laguna province).
[12] Last date of revision: July 1999.
[13] Based on the findings of the Malaysia–Japan Chamber of Commerce and Industry (JACTIM, October 2001).
[14] Amata Nakorn estate → Laem Chabang port ($101) → Port of Yokohama ($1,350).
[15] Selangor Science Park → Kelang Port ($107)→ Port of Yokohama ($590).
[16] Bekasi area→ Tanjungpriok Port → Port of Yokohama.
[17] Laguna → Port of Manila → Port of Yokohama.
[18] Ha Noi → Hai Phong Port → Port of Yokohama.
[19] 10-20% for manufacturing industry and 25% for hotels, finance, insurance and service industries (preferential tax rate is 10-20%) as stipulated in the Government decree providing detailed regulations on the implementation of the law on foreign investment in Vietnam (No. 24-2000-ND-CP).

4-2-1-3 For small- and medium-sized enterprises

In order to promote supporting industries it is strongly needed to attract many foreign small- and medium-sized enterprises by changing policy that disadvantages companies of small investment scale and volume. Automobile production requires not only first-tier suppliers but also second- and third-tier suppliers. As these small companies do not have much capital, they should be provided preferential treatment.

One idea is to build low-rent or rent-free industrial parks for clusters of foreign and joint venture SMEs. Such ventures should be permitted to import secondhand machines without import duties for their production lines. Japanese, Korean SMEs suffering from high production costs in Japan, Korea and Chinese SMEs expecting to produce parts and components mainly for export to ASEAN countries are the types of companies that should be targeted. One suggestion is to use currently idle SOE land and equipment to attract SMEs, allowing them to quickly adjust to Vietnam's market and other systems. This scheme or one incorporating special areas that are rent-free or benefit from tax relief would make Vietnam a more attractive option for FDI by export-oriented SME manufacturers.

In China some special economic areas provide attractive incentives for FDI and have been successful in industrial promotion. Those incentives include investment by the Chinese government in the preparation and maintenance of public utilities, roads, ports, electricity and so on.

4-2-1-4 Foreign capital parts industries that are strongly desired in Vietnam

When developing supporting industries for a country's automobile industry, the first parts to be produced are typically tires and batteries. At present, most car parts can not be procured locally in Vietnam; the only exceptions are wire harnesses, antennas and car seats. Regarding wire harnesses, a few units of the otherwise export-bound production of Sumi-Hanel and Yazaki are being bought by domestic car assembly makers. Considering the current market size, it is difficult for car parts makers to commit to establishing local operations.

As many parts makers have already invested in ASEAN four countries, it is difficult to find complementary parts industry for Vietnam. However, it is necessary to attract various parts companies into Vietnam in order for Vietnamese automobile industry to have unique competitiveness. Vietnamese production of automobile parts that can participate in the auto parts complementation system in the ASEAN market will be welcomed. The ideal is for an ASEAN market that features a complementary supply system.

The following product categories are likely candidates for investment into Vietnam.
(Those taking advantage of skilled workers as well as relatively low labor costs)

- Casting
- Forging
- Leather components (Those that involve the assembling of bulky parts)
- Car seats
- Fuel tanks
- Exhaust pipes
- Relatively big resin parts and outer panels (Those primarily taking advantage of relatively low labor cost)
- Wire harnesses
- Antennas
- Sewing of car seat covers (Components and parts for the existing export oriented parts makers in Vietnam)
- Small resin parts

- Small rubber products (Those arising from synergy with the motorbike industry)
- Cables
- Shock absorbers

Casting, forging and leather components are suitable parts industries for Vietnam because they are expected not only to make good use of Vietnamese skilled workers but also to employ an additional labor force. These industries are labor intensive, and in the near future other countries will have difficulties hiring large numbers of employees.

Domestic assembly of bulky car parts such as car seats, fuel tanks and exhaust pipes is expected because it is costly to import them from overseas.

Some parts and processes for which labor is a major cost are also suitable for Vietnam (e.g., wire harnesses, antennas and the sewing of car seat covers). Vietnam has a competitive advantage for such kind of labor intensive parts and processes and already has seen such investment.

For obvious production volume reasons, parts makers want to supply their parts not only to the automobile industry but also to the motorbike industry. Cable and shock absorber production is well suited for Vietnam because of the considerable synergies between the automobile industry and the motorbike industry. As the market volume of motorbike parts is huge, parts makers will be able to enjoy economies of scale.

The introduction of supporting industry FDI in Vietnam will contribute to an increase in (will have a ripple effect on) production by existing supporting and material industries such as rubber, plastics and glass industries.

To attract FDI, Vietnam has to prepare a set of measures that are unrivaled by other countries. It is imperative for Vietnam to attract FDI as soon as possible and generate competitiveness ahead of 2006.

4-2-1-5 Examination of incentives that are compliant with WTO rules (e.g., production incentive and R&D incentive)

The WTO agreements about industrial goods prohibit subsidies for exports and subsidies contingent upon the use of domestic over imported goods, because they have a particularly high trade-distorting effect. Before joining the WTO, it is possible to provide incentives to promote strategic industry and export subsidies; but after joining, some such incentives are prohibited. Under GATT Article III,[16] all WTO members are required to provide national treatment to all members.

The objective of the WTO is to maximize world economic welfare that crucially hinges on economic efficiency. From the perspective of economic efficiency, the exemption rule in the SCM Agreement may be understood as the mechanism to promote competitiveness of the economy. There is a few non-actionable subsidies under WTO SCM agreement. Based on the WTO accession processes of other countries, it is hardly easy to keep domestic incentives even if it is allowed through GATT Article III: 8(b). Industrial incentives that are compatible with WTO rules [17] are necessary. One example is the Automotive Competitiveness and Investment Scheme (ACIS) in Australia. It was introduced in 2001 to

[16] GATT Article III: 1 (National Treatment Principle): This provides that WTO members must not apply internal taxes or other internal charges, laws, regulations and requirements affecting imported products so as to afford protection to domestic production.

[17] *Domestic Subsidies* (GATT Article III: 8(b)): This allows for the payment of subsidies exclusively to domestic makers as an exception to the national treatment rule. In order to avoid negative impact on trade, the WTO members are obliged to meet the condition that such payment is not in violation of the Agreement on Subsidies and Countervailing Measures (SCM).

develop the automobile industry by encouraging new investment and innovation. Assembly makers and parts makers can receive duty-free allowance from the Customs Office, depending on the size of production, capital or R & D investment.

Prior to joining the WTO and in the 5-year BTA process of phasing out TRIMs by November 2006, it is necessary to make active use of various incentives to encourage production, investment and R&D of domestic automobile makers and to invite FDI parts makers to Vietnam.

4-2-2 Preferential tariff system depending on the production level or assembled parts level

A gradual tariff structure (progressively lower tariffs for completely assembled cars, KD parts, and KD part components) as implemented by Thailand and Indonesia should be considered. And imports of raw materials for parts and components should not be assessed import duties, because it is difficult to procure suitable raw materials domestically.

Currently, there are few parts makers (except foreign parts makers) to provide high quality parts for automobile manufacturers in Vietnam. Therefore, the hurdle for preferential tariff eligibility in the Vietnamese automobile industry should be lower than that in the automobile industry in Thailand and Indonesia and lower that that of the domestic motorbike industry.

Breakdown requirement, like that introduced in Thailand and Indonesia, is another means to promote domestic industry. In it, the import duties are varied in line with the classification level of the assembled parts; the more the parts are broken down or assembled in the country, the less the duties paid.

Reduction of import duties on imported parts will contribute to reduction of the retail price of domestically produced automobiles. This will also increase consumer utility.

Box 4-2 Automobile possession tax:

In some developed countries, the owners of automobiles have to pay automobile possession tax every year. This is imposed based on the automobile registration. If the tax is unpaid, the registration renewal is not admitted. As this tax does not superficially push up the retail price of the automobile, not much consideration is given its influence on automobile demand. Such a property tax is one way to apply a domestic tax to automobiles.

4-2-3 Preferential measures to improve local procurement

Developing and strengthening supporting industry are means by which the Vietnamese government can improve industrialization. One typical means to develop supporting industry is to encourage local procurement. However, localization promotion policy will harm not only manufacturers but also consumers if it is not implemented under the right conditions. If an increase in local procurement is mandated when the supporting industry of the country is immature, high quality and low price cars can not be produced. Vietnam's current situation requires policy that motivates domestic manufacturers to procure locally, including the use of incentives.

Because local procurement rules do not conform to WTO rules against discriminatory treatment, Vietnam with accession is therefore compelled to modify any provisions of its investment law that are inconsistent with its obligations under the WTO TRIMs agreement. The Vietnam-US BTA states that Vietnam must do so within five years of signing the BTA (i.e., by November 2006) or as required by the terms of WTO accession.

The WTO allows exceptions because of the necessity to provide "handicaps" according to a country's stage of economic development. The WTO allowed some countries, such as

Malaysia and the Philippines of ASEAN, to postpone their abolishment of local content policy in order to develop their own automobile industries. However, as the extension will expire in 2004, thus opportunity for Viet Nam to use this exception seems to be remote.

While measures need to be taken to encourage local procurement on the assemblers' side, an increase in the number of domestic auto parts suppliers is also necessary. To increase the local procurement in the short term, there is a need to call FDI parts makers, whose products would be available to domestic automobile assembly makers to help them increase their local procurement. Local procurement will increase step by step along with the increase in the number of FDI parts makers. Due to the currently low production level, however, the domestic parts demand in the automobile market is very limited compared to that in the motorbike market. Therefore, it is necessary for parts makers to adopt export-oriented strategy. The government should adopt export promotion policy and create incentives for such automobile parts makers.

One idea to reduce automobile production cost is to procure low price (low tariff) imported parts and parts produced by foreign capital parts makers that invest in Vietnam. The latter's products are mainly for export, and if some of them are supplied for automobile manufacturers at low price, then car prices will decrease. In addition, it is possible to allow the foreign auto-makers to provide import and distribution services based on export performance. In order to attract such foreign capital parts makers to Vietnam the introduction of incentives that promote export are necessary. Through this process, some internationally competitive parts industries become involved in the global strategies of multinational companies, and the government supports these industries to increase their export and promote supporting industries as a whole.

In order to take advantage of low prices, the introduction of preferential import duties for imported parts is necessary. When the preferential import duties are introduced, the government has to take into account the present situation of automobile manufacturers. Tariffs on some items should be kept high to protect some key Vietnamese supporting industry. If the tax system does not reflect current market conditions, it will harm the promotion of automobile industry in Vietnam.

4-2-4 Promotion of local companies

Currently there are few parts that can be procured domestically, because of quality, safety and durability issues. Increase in outsourcing parts from local companies is needed in order to develop Vietnam's industry. Foreign capital manufacturers (with Vietnamese government assistance in such aspects as collecting information) should try to find suitable suppliers and subcontractors from among local companies.

The reason foreign capital companies want to procure local products is to reduce both foreign exchange risk and production costs. However, it can be difficult for foreign companies to find local companies capable of producing the desired products. The government should provide foreign companies detailed information about possible matches with local companies. For example, if the Ministry of Industry issues a detailed list of local companies, including information on the technical expertise of each of those companies, it will be easier for foreign companies to find suitable local suppliers, thus accelerating foreign technical transfer and increasing the scope of supporting industries.

The local makers are attracted to preferential loans from SOCBs and to priority projects that involve link-ups with foreign companies. If they have loans to improve their production quality through new technology and machines, their chances to link up with car manufacturers and foreign parts makers will broaden.

4-2-5 Human resource development

In order to encourage local companies, it is important for foreign capital manufacturers not only to increase their subcontracting activities but also to provide guidance including technical assistance and training.

At present, car maintenance technicians are trained in some vocational training schools. But the numbers and levels of students are low. In the near future human resources for automobile industry will be a bottleneck in the promotion of the industry.

From the viewpoint of incentives for companies it is expected that corporate tax calculation will include exemption for training cost.

4-2-6 **Technology transfer**: Examination of the system to transfer technology smoothly from foreign companies to local companies

Examining the feasibility of establishing or revising systems for royalties and the protection of intellectual property rights is necessary.

Regarding technology transfer, the lack of a system is the problem. In Vietnam the duration of technical transfer agreements is just seven years and royalty payments are usually computed at 3-4 percent (with the maximum being 5%, and that for automobile industry, 3.9%), whereas royalty payments in Japan are computed at 6 percent. The agreements must be lengthened, the royalties must be increased and a proper legal system should be introduced for progress to be made in technology transfer through FDI. Introduction of international rules and legal framework will bring about an increase in FDI.

Regarding intellectual property rights, both governments agreed in the Vietnam-US BTA that initial registrations of trademarks be for a term of at least ten years, patents more than twenty years, and industrial designs at least ten years. Vietnamese rules are getting closer to international standards.

4-2-7 Phases for export promotion

Development of supporting industry in Vietnam will be encouraged through inviting foreign automobile parts makers who have unique competitiveness. Inviting those parts makers will also be beneficial in terms of export promotion, as they will export their parts and components to other countries.

a. Use of AICO

AICO is a preferential tariff scheme aimed at promoting mutual complementation between companies based in the ASEAN forum by accelerating the realization of AFTA. AICO targets industrial products traded within the ASEAN forum (all non-GEL products with ASEAN content of at least 40%). Once a country has attained AICO recognition from a trading partner, then the duty on AICO items imported from that country is lowered to 0–5 percent. Totally, ninety items have been granted AICO status (as of April 2002). The number of automobile-related items has risen to a total of seventy-six (as of April 2002). AICO status is used mainly for automobile parts in ASEAN.

Japanese car manufacturers in particular have put AICO to good effect in reinforcing and expanding the scope of parts complementation within the ASEAN region. For example, Denso has used AICO with great success in establishing a parts complementation system in which Thailand, Indonesia, Malaysia and the Philippines are separate production bases

for electric, compressor, electronic and meter parts, respectively, connected by the hub of Denso International Singapore.

Thus, car and car parts companies have worked toward integrating the ASEAN countries into a single market, using intensive production and parts complementation to generate economies of scale to a degree which would not be possible in any one of the member countries.

In Vietnam there are just five cases in which AICO status is applied. Most of them are electric appliance parts. It is expected that more foreign capital manufacturers in Vietnam will receive AICO status.

At this stage Vietnam should invite leading foreign capital automobile parts makers whose products are not produced in other ASEAN countries. In terms of the production base breakdown for particular car components in each ASEAN nation, diesel engines are produced in Thailand, manual and power steering mechanisms are produced in Malaysia, gasoline engines are produced in Indonesia, and transmissions are produced in the Philippines.

In order to attract export-capable parts makers to Vietnam, AICO terms will be necessary. In practice, some competitive large-scale parts makers require AICO operations as a condition for setting up local operations.

b. Use of CEPT

CEPT, which among AFTA nations frees up mutual trade in all products with an ASEAN content of 40 percent or greater (almost all industrial and agricultural products), will start in January 2006 in Vietnam. This freeing up of trade is to take the form of the removal of non-tariff trade barriers and the reduction of import duties to 0–5 percent. The CEPT scheme will be applied to auto parts, including CKD, from 2003 and their import duties will be reduced to below 5 percent in 2006. By implementing this scheme, Vietnam will see decreased production cost. Therefore CEPT should be put into effect as scheduled. However, in order to enjoy the benefit from this scheme, the products need to be listed on the IL, and thus automobile parts should be moved to the IL. On the other hand, if the automobile manufacturing industry is to be promoted, CBU vehicles need to be kept on the GEL for a while. Negotiation to keep CBU vehicles on the GEL should be continued, although the pressure to open the market will be strong, especially after Vietnam joins the WTO.

The first ASEAN member countries to sign on (Thailand, Malaysia, Indonesia, the Philippines, Singapore, and Brunei Darussalam) do so in 2002. As is the case with AICO, CEPT enables automobile assembly makers to procure lower cost parts. By attracting internationally competitive parts makers, Vietnams relationship with ASEAN nations producing automobile parts should be complete and ready for implementation as soon as possible.

c. Strategic use of export parts

Starting with parts production for intra-ASEAN exports is the most strategic policy for promotion of Vietnam’s automobile industry. The government must devise some way of realizing a system to support this policy.

Using a ban on CBU import and high tarrif to partically block the import of cars in order to expand domestic production are considered essential for expanding of automobile market. However, such bariers are not allowed under WTO and AFTA rules, and the high protective measurs seem to be very costly caused by the high production cost, It should

therefore have to set the midle way to grant export incentives by allow import of automobiles based on CBU export performance.

Import duties on parts and materials for parts production should be reduced to a level that does not hinder domestic parts production. Normally, tariffs on parts and materials which can be produced locally should be set high and kept high, but in Vietnam's case, there are very few parts and materials that can be produced locally, and the high reliance on imports will continue for some time to come.

As for policy to promote the automobile industry, leading parts that are not currently produced in large volumes in the ASEAN region should be identified, and the car parts industry should strategically target the production of those parts. As a result, the progress of car parts promotion should have a relationship with policy to attract FDI. That is, Vietnam should put itself in a position of exporting parts within the ASEAN region and use this place of privilege to attract parts makers from advanced countries. In this way, advanced parts makers will produce car parts not only for export to the ASEAN market but also for the Vietnamese market and will gradually step up the level of local parts production.

In order to promote such auto parts export, it is also important to prepare infrastructure, develop Free Trade Zones (FTZ), establish a quick refund system of import duties, and create various export incentives. When we consider promoting export parts industry in Vietnam, it is important to include the exemption of import duties for import materials and parts for exporting companies.

Inviting prominent parts makers to Vietnam is a key factor in the preparation of a foundation for the Vietnamese car industry. For this purpose, legal conditions must be adjusted to allow for the immediate utilization of the important AICO scheme, and a wide-ranging portfolio of investment incentives should be put forward. For the time being, Vietnam should aim for participating in mutual car parts complementation with ASEAN countries, due to its larger market size. First, It will have to determine which parts to produce and then set a focused policy to do it.

It will not be possible to bring up a competitive car parts industry by targeting the Vietnamese domestic market exclusively, due to its limited size and limited potential for growth. Exports are essential, as is a preferential tax system to encourage them. For this purpose, it is vital that parts makers with export competitiveness come to Vietnam. Therefore, the preferential tax system and measures should include production incentives as well as exemption of import duties on base materials, parts, etc.

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